



MONEY DUE REWARDS:

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FINANCIAL SERVICES

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Redundancy

Now that the economic turmoil of the last year or more is starting to affect the real world, staff layoffs are becoming more common in many industries. For long term employees who are made “redundant”, it is a big issue. In some cases, it may mean an unintended early retirement, while for others it can be a stepping stone to something new. For those who have many years of service with a large employer, it may also be fairly lucrative – as well as being extremely complicated.

The income tax rules concerning redundancy payments have always been fairly complex. From 1 July 2007, however a brand new set of rules was introduced in conjunction with Mr Costello’s “Simpler Super” regime. Provided the redundancy is genuine, there is a tax free amount available which increases depending on the number of years of service which the employee had with the employer. The remainder of the payment is taxed at a rate depending on whether the employee is above or below 55, and how much is being paid. The first \$145,000 is taxed at 31.5% for those below 55, while those who are older only pay 16.5%. Any amount over \$145,000 is taxed at the top marginal rate.

If however, the employee receives a payment under an agreement in place at 9 May 2006, the payment is regarded as “transitional” and the tax treatment is considerably more lenient. For those in both age categories the tax rate is limited to 31.5% up to an amount of \$1.045 million. This may be particularly good news for some of the redundant “high flyers” in the finance sector, although it may not benefit the rest of us terribly much.

More relevant for this “transitional” group, however is the fact that they are also allowed to “roll over” the taxable part of their redundancy package into their superannuation fund, if they choose. In doing so, the tax rate is generally limited to 15%, and this is often what people choose to do.

Take Fred, for instance, who at 38 was made redundant from his position as a hedge fund manager after ten years of employment, and received a redundancy payment of \$150,000. The first \$44,110 is tax free and must be taken in cash, whereas the balance of \$105,890 is taxed at 31.5%, giving tax of \$33,355. Because he falls into the “transitional” group, Fred may choose to put the \$105,890 into his superannuation fund, thus reducing the tax payable to \$15,883.

While working out the tax consequences is complicated enough, those facing redundancy also have to work out what to do with the cash, and sometimes some pretty difficult choices have to be made. For those who are younger, uncertain of their employment prospects, and perhaps with some outstanding debt, there are quite a few problems to solve. While superannuation may offer a lower tax rate, both for “rolled over” redundancy payments and for investment earnings, it may not be appropriate for those who need the cash for debt repayments, or simply to pay living expenses.

In some cases, some useful strategies can be crafted using pre-retirement pensions or salary sacrificed super contributions, however in other instances it is simply better to pay the tax and take the cash.

Speak to a professional financial advisor if you find yourself in this situation, as this is one set of circumstances where such advice is likely to be particularly helpful and relevant.

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