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Taxation of termination payments

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/ (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/)
- Last modified: 28 Mar 2017
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Taxation of termination payments

This information explains how employers who are terminating an employee's employment calculate and report the tax on any termination payments.

Employees can be paid several types of 'lump sums' that are taxed and reported differently to normal income. A lump sum payment is a one-time payment, usually provided instead of having to make recurring payments over a period of time.

An employment termination payment (ETP) is one of these lump sums.

A 'life benefit ETP' is paid to an employee. If the employee has died, a 'death benefit ETP' is paid to their estate.

The steps below help you work out:

1. which payments to include in the employee's ETP
    - ETPs include things like gratuities and severance pay, but not payments for accrued annual leave or the tax-free part of genuine redundancy payments.
2. payments for accrued annual and long service leave
    - These payments are not part of the employee's ETP but may receive concessional tax treatment.

3. the tax-free amount if the termination is because of a genuine redundancy or early retirement scheme
    - Payments for these types of termination are tax free up to a certain limit. The tax-free amount is not part of the employee's ETP.

4. if any of the ETP is tax-free
    - An ETP has a tax-free component if part of the payment is for invalidity or work done before 1 July 1983. You don't withhold from this component.

5. how much of the ETP is taxed at a concessional rate
    - ETPs are concessionally taxed up to a certain limit, or 'cap'. There are two caps – which one applies depends on the type of payment.

6. the amount to withhold and how to complete the payment summary
    - You withhold from the taxable component of the ETP at concessional rates up to the applicable cap and at the highest marginal rate for amounts above the cap.

A payment must generally be made within 12 months of termination to qualify as an ETP and receive concessional tax treatment. Otherwise the payment is part of the recipient's assessable income and is taxed at their marginal rates.

Informing your employees

Termination payments for employees (/Individuals/Working/In-detail/Termination-payments/Termination-payments-for-employees/) explains:

- how termination payments are taxed
- how the caps work, including the tax implications for employees who are subject to the whole-of-income cap
- what employees need to do with their payment summaries and how to report these payments on their tax return.

You can provide this information to employees with your letter of offer or PAYG payment summaries.

Payments that are ETPs

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=2 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-

of-termination-payments/?page=2)
- Last modified: 28 Mar 2017
- QC 26218

Use the table below to work out which payments to include in the employee's ETP.

Payments that are ETPs	Payments that are not ETPs
A gratuity or golden handshake	Accrued leave payments for unused annual leave and long service leave
Genuine redundancy or early retirement scheme payments above the tax-free limit	Genuine redundancy or early retirement scheme payments up to the tax-free limit
Severance pay	Salary, wages, allowances, bonuses and incentives owing to the employee for work done or leave already taken
Non-genuine redundancy payments	Super benefits (for example, a lump sum or income stream from a super fund)
Payments in lieu of notice of termination	Foreign termination payments
Unused rostered days off (RDOs)	Certain payments for restraint of trade
Unused sick leave	Certain payments for personal injury if you are compensated for your inability to be employed
Compensation for loss of job	Employee share scheme payments
Compensation for wrongful dismissal, provided it is paid within 12 months of the actual termination of employment	An advance or loan
Payments for loss of future super payments	
Payments arising from an employee's termination because of ill health (invalidity), other than compensation for personal injury	
Lump sum payments paid on the death of an employee	

Next steps:

- Accrued leave
- Redundancy and early retirement
- Tax-free component of ETPs
- Applying the ETP caps

Accrued leave

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=3 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=3)
- Last modified: 28 Mar 2017
- QC 26218

Lump sum payments for unused annual leave and long service leave are not part of the employee's ETP. They are separately recorded on the employee's *PAYG payment summary – individual non-business* at lump sum A or B.

These payments may be concessionally taxed. The tax rate depends on the type of termination, date of accrual and type of leave.

Next step:

- Work out the amount to withhold and which lump sum category to use - Schedule 7 – Tax table for unused leave payments on termination of employment (/Rates/Schedule-7---Tax-table-for-unused-leave-payments-on-termination-of-employment/).

See also:

- PAYG payment summary – individual non-business (/Forms/PAYG-payment-summary---individual-non-business/)

Redundancy and early retirement

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=4 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-

of-termination-payments/?page=4)
- Last modified: 28 Mar 2017
- QC 26218

Genuine redundancy and early retirement scheme payments are tax free up to a limit based on the employee's years of service.

The tax-free amount is not part of the employee's ETP. It's reported as a lump sum in the employee's *PAYG payment summary – individual non-business*.

Any amount over the tax-free limit is part of the employee's ETP.

On this page:

- Working out and reporting the tax-free amount
- Redundancy
- Early retirement scheme

Working out and reporting the tax-free amount

The tax-free limit is:

Base amount + (service amount × years of service)

The base amount and service amount are indexed annually.

For example, for 2016-17 the tax-free limit is $9,936 (base amount), plus $4,969 (service amount) multiplied by the years of service. Therefore, for 10 years service, the tax-free limit for the year ending 30 June 2017 is:

$9,936 + ($4,969 × 10) = $9,936 + $49,690 = $59,626

The tax-free component of a genuine redundancy or early retirement scheme payment is shown at lump sum D on the employee's PAYG payment summary – individual non-business.

See also:

- ETP caps - Tax table for employment termination payments (/Rates/Schedule-11---Tax-table-for-employment-termination-payments/?page=2?page=2#footnote1https://www.ato.gov.au/Rates/Schedule-11---Tax-table-for-employment-termination-payments/)
- PAYG payment summary – individual non-business (/Forms/PAYG-payment-summary---individual-non-business/)

Example: Genuine redundancy, tax-free component only

Moira is 42 and started working for EFG Pty Ltd on 1 July 2001. Moira is being made redundant because the company has merged with another company as of 1 July 2016 and Moira's role is no longer needed. Moira is being paid 2 weeks for each year of service and her weekly earnings are $2,000. Because Moira is receiving a genuine redundancy she is entitled to the tax-free component. The tax-free limit for Moira is $9,936 + $4,969 ×15 (each completed year of service).

Moira received $60,000 in redundancy payment and she is entitled to an $84,471 tax-free component. The whole of Moira's redundancy payment is tax free, so she won't receive an ETP payment summary. All of Moira's redundancy payment will appear on her individual non-business payment summary at lump sum D.

Example: Genuine redundancy

Sonya is a 54-year-old chief financial officer (CFO) who has been working for Green Waste for 10 years. In 2016–17, Green Waste is taken over by a larger company, which already has a CFO. Sonya's position is no longer needed and her employment is terminated. She accepts a redundancy and is paid $190,000, $140,000 of which she would not have received if she had not been redundant. Her other taxable income in 2016–17 is $200,000.

Sonya's payment is a genuine redundancy payment because her position is no longer required, even though the position of CFO still exists – the position does not need to be filled by two people.

The genuine redundancy part of Sonya's payment is $140,000. The tax-free part of the payment is $59,626, based on 10 years service. The remaining $80,374 is subject to the ETP cap (not the whole-of-income cap) and is taxed concessionally because it is under the ETP cap.

The lesser of the ETP cap and whole-of-income cap applies to the remaining $50,000.

Because Sonya has earned $200,000 other taxable income, her calculated whole-of-income cap is zero and is the lower cap. As a result, Sonya's ETP amount of $50,000 will not receive concessional tax rates and withholding will be at the highest tax rate (49% in 2016–17).

Redundancy

Only a payment for a genuine redundancy is eligible for the tax-free limit. A genuine redundancy occurs when the employee's job is abolished – that is, the employer has made a decision that the job no longer exists, and the employee's employment is to be terminated.

A payment for a non-genuine redundancy is taxed as part of the employee's ETP.

A non-genuine redundancy occurs when the employee:

- is dismissed because they've reached normal retirement age
- leaves voluntarily
- has their contract terminated
- is dismissed for disciplinary or inefficiency reasons.

See also:

- Taxation Ruling TR 2009/2 (/law/view/document?DocID=TXR/TR20092/NAT/ATO/00001) *Income tax: genuine redundancy paym*ents

Dismissal

Dismissal is the involuntary termination of an employee. It's the employer's decision that the employment will end, rather than the employee's decision to leave.

Provided that it's ultimately the employer's decision to cease employment, a dismissal can still occur when the employer offers a redundancy package to an employee to either:

- minimise disruption to other employees
- comply with industrial relations laws or a workplace agreement.

A redundancy is still considered genuine if the employer seeks expressions of interest from their employees before they decide which employee to dismiss.

Sometimes an employer places an employee in a position where there is little choice but to resign – for example, when the employer offers their employee any of the following:

- the choice between a package and another job that is different to their qualifications and experience
- a reduction in their pay
- dismissal without the benefits of a package.

In these situations the dismissal is generally not a genuine redundancy.

See also:

- Taxation Ruling TR 2009/2 (/law/view/document?DocID=TXR/TR20092/NAT/ATO/00001) *Income tax: genuine redundancy payments*

Early retirement scheme

An early retirement scheme is a plan that offers employees incentives to retire early or resign when the employer is rationalising or reorganising their business operations.

The scheme must meet certain conditions and be approved by us. Approval will be provided to the employer as a class ruling. You can't start an early retirement scheme until you have the class ruling.

An early retirement scheme will generally be approved when it meets the following conditions:

- It is available to broad groups of employees, such as all employees
  - hired by the organisation
  - who have reached a particular age
  - with a particular occupational skill.

- It is part of a plan to reorganise business operations. You must be able to show that you are implementing the scheme to achieve a specific short-term objective. A specific objective may include
  - replacing employees with particular skills with employees who have different skills
  - the closure, relocation or reduction in output of part of the business operations
  - the introduction of new technology, processes, systems or productivity increases.

Your request should be in writing and include:

- the date of effect (ie the proposed timeline of the scheme)
- the employer's name and contact details
- a full and accurate description of the scheme
- a clear and accurate description of the class of persons subject to the scheme
- any supporting documents.

The request can be faxed to **1300 669 846** or mailed to

Australian Taxation Office
PO Box 3100
Penrith NSW 2740

See also:

- Payments that are ETPs
- Applying the ETP caps

Tax-free component of ETPs

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=5 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=5)
- Last modified: 28 Mar 2017
- QC 26218

An ETP has a tax-free component if part of the payment relates to:

- employment before 1 July 1983
- invalidity.

The tax-free component may include both of these. The remainder of the ETP is the taxable component.

You should:

- record the taxable component and any tax-free component on the employee's ETP payment summary
- not withhold from the tax-free component.

Employment before 1 July 1983

If part of the ETP relates to employment that occurred before 1 July 1983, the amount to include in the tax-free component is worked out as follows:

Step 1: Subtract the invalidity part (if any) from the ETP.

Step 2: Multiply the amount at step 1 by the fraction:

$$\text{Number of days of employment before 1 July 1983 to which the ETP relates} \div \text{total number of days of employment to which the ETP relates}$$

Invalidity

An invalidity segment is part of an ETP that is paid because the employee sustained a permanent disability. It's tax free. An invalidity segment can be paid if:

- employment ceased as a result of ill health, and
- two medical practitioners have certified that it is unlikely the employee can ever be gainfully employed in the capacity for which they are reasonably qualified.

A death benefit ETP can't include an invalidity segment.

The invalidity segment of the ETP represents the time between the day employment stopped and the day the employee would have retired. It's worked out using the formula below.

Note that in the formula:

- 'Days to retirement' are the number of days from the date of termination to the day the employee would have retired. This is generally the day the employee turns 65 or when they would have completed their period of service.
- 'Employment days' are the number of days of employment up to the date of termination.

$$\text{Amount of employment termination payment} \times \frac{\text{Days to retirement}}{\text{Employment days + Days to retirement}}$$

Example: Employment termination payment with an invalidity segment

Jackson started work with XYZ Pty Ltd on 1 September 2008. He is no longer able to work on medical grounds, and is terminated on 20 September 2016 due to invalidity. XYZ Pty Ltd pays Jackson an ETP made up of the following:

- golden handshake $40,000
- unused rostered days off (RDOs) $2,000
- unused sick leave $10,000
- compensation $50,000.

Because each payment is made for termination due to invalidity, the whole ETP ($102,000) is used to calculate the invalidity segment.

- $102,000 × [371 ÷ 3,313 (ie 2,942 + 371)] = $11,422

This $11,422 of the $102,000 is the invalidity segment, which is the tax-free component and the remaining $90,578 is taxable.

Next step:

- Applying the ETP caps

See also:

- Employment termination payment with an invalidity segment worksheet (/Print-publications/Employment-termination-payment-with-an-invalidity-segment-worksheet/)

Applying the ETP caps

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=6 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=6)
- Last modified: 28 Mar 2017
- QC 26218

ETPs are concessionally taxed up to a certain limit, or 'cap'. The top rate of tax applies to amounts in excess of the cap.

There are two caps:

- the ETP cap, which is
  - indexed each year (in 2016–17 it's $195,000)
  - reduced by any earlier ETPs paid in the same income year, and by any earlier ETPs for the same termination regardless of when they are paid

- the whole-of-income cap, which is
  - $180,000
  - reduced by any other taxable payments (such as salary and the taxable components of any earlier ETPs) received by the employee in the same income year.

Which of these caps applies depends on the type of payment. For example, a genuine redundancy payment and a 'golden handshake' may be subject to different caps.

Find out about:

- Which cap to apply
- Working out the whole-of-income cap amount
- Multiple payments
- Withholding and payment summaries

See also:

- ETP cap for the current and other years (/rates/key-superannuation-rates-and-thresholds/?page=20#ETP_cap_for_death_benefit_termination_payments)

Which cap to apply

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=7 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=7)
- Last modified: 28 Mar 2017
- QC 26218

Which cap applies depends on the type of payment.

Apply the ETP cap to 'excluded payments':

- genuine redundancy and early retirement scheme payments that exceed the tax-free limit (only the amount in excess of the limit is subject to the cap)
- payments that would have been for a genuine redundancy had the employee not reached their retirement age
- invalidity payments (only the amount not included in the tax-free component is subject to the cap)
- compensation payments principally for personal injury, unfair dismissal, harassment or discrimination
- death benefit ETPs.

For all other ETPs, apply the lesser of the ETP cap and the whole-of-income cap. These are called 'non-excluded payments' and include:

- golden handshakes and gratuities
- non-genuine redundancy payments (unless it would have been a genuine redundancy had the employee not reached their retirement age)
- payments in lieu of notice

- payments for unused sick leave or unused rostered days off.

In the majority of cases the whole-of-income cap will be less, so it will apply to these payments.

The only exception is if you make multiple payments to the employee for the same termination. The ETP cap is reduced by the other payments – even if they occur in different income years – and could then be lower than the whole-of-income cap.

Next steps:

- Working out the whole-of-income cap amount
- Multiple payments
- Withholding and payment summaries

Find out about:

- Categorising payments
- Compensation payments

Categorising payments

In some circumstances, a non-excluded payment, such as unused sick leave, may be classified as excluded and subject only to the ETP cap. You need to categorise each payment as excluded or non-excluded based on the following factors:

- the employment conditions – for example, what you're reasonably required to pay under the industrial agreement or employment contract for that termination type
- that what is paid is extra, discretionary or separate to what is reasonably required for that particular type of termination.

This example shows how a payment for unused sick leave may be classified as an excluded payment. Other non-excluded payments may be classified as excluded in similar circumstances.

Compensation payments

Payments that are made principally to compensate a person for a genuine dispute from personal injury, unfair dismissal, harassment or discrimination are excluded from the whole-of-income cap. A payment does not need to be made as a result of proceedings before a court to be deemed as compensation – however, the employee or employer should keep evidence to show that a genuine dispute existed.

Example: Compensation for unfair dismissal

Julie's employment was terminated by her employer. Julie has evidence that she was unfairly dismissed because of her strong union affiliation and disputes her termination by engaging a lawyer to act on her behalf.

The lawyer negotiates a $20,000 out-of-court settlement with Julie's employer for unfair dismissal.

Although Julie's complaint did not go to court, there was a genuine dispute between Julie and her employer that resulted in compensation for her unfair dismissal. Her payment of $20,000 is a compensation payment and will be subject to the ETP cap and excluded from the calculation of the whole-of-income cap.

Example: Compensation for harassment and discrimination

Monica's employment was terminated in September 2016 because of alleged poor work performance. Monica feels that she was unfairly dismissed, believing that her dismissal was actually as a result of a harassment claim she lodged against her manager. She takes court action against her employer and receives a payment of $150,000. Monica has other taxable income of $100,000.

Because the payment is a result of the termination of her employment and made to compensate her for harassment and discrimination, it is subject to the ETP cap (that is, $195,000 for 2016–17) and excluded from the whole-of-income cap. Therefore the entire $150,000 of her payment will receive concessional tax treatment regardless of her other income.

Working out the whole-of-income cap amount

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=8 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=8)
- Last modified: 28 Mar 2017
- QC 26218

The $180,000 whole-of-income cap is reduced by any other taxable income earned in the income year either before or after receiving the ETP.

For the purposes of withholding from the ETP, you work out the cap based on the employee's taxable income before they are terminated.

If the employee earns more taxable income in the same income year after the termination – for example, they get another job – they may pay more tax on their ETP when they lodge their tax return. This is because the taxable income earned after the termination will further reduce their whole-of-income cap.

Example: Applying the whole-of-income cap

Emilio is a 61-year-old former commercial pilot who retired from his job in November 2016. His taxable income from his wages in 2016–17 up to that point was $100,000. His employer paid him an ETP of $50,000, in the form of a gratuity.

Emilio's ETP is a non-excluded ETP, so the lesser of the two caps applies.

- Emilio's whole-of-income cap is reduced from $180,000 to $80,000 because he earned $100,000 in 2016–17.
- This is less than his ETP cap (/Rates/Schedule-11---Tax-table-for-employment-termination-payments/?page=2#ETP_caps) ($195,000 for 2016–17), so the calculated whole-of-income cap applies to his ETP.

Since Emilio's ETP ($50,000) is less than his calculated whole-of-income cap ($80,000), his entire ETP is taxed at concessional rates.

Emilio has reached his preservation age (/Rates/Schedule-11---Tax-table-for-employment-termination-payments/?page=6#Preservation_age), so his employer withholds tax at a rate of 17% from his ETP.

Other taxable income for whole-of-income cap

The whole-of-income cap takes into account other taxable income that the employee earns in the same income year. Other taxable income is simply assessable income minus deductions the employee is entitled to.

Taxable income includes:

- salary or wage income (including payments for overtime)
- bank interest
- bonuses
- accrued leave you may have been paid when your job was terminated

- the taxable component of other ETPs received earlier in the same income year – see Example: ETP paid in instalments.

If the employee receives a lump sum payment for unused long service leave that accrued before 16 August 1978 (shown at label B on a PAYG payment summary – individual non-business), only 5% of this payment is included in other taxable income.

Taxable income does not include:

- reportable fringe benefits
- salary sacrifice items
- super guarantee
- reportable employer super contributions
- reimbursements of work-related expenses
- the taxable component of the excluded part of a single employment termination payment that is part excluded and part non-excluded – see
  - Example: Single ETP with excluded and non-excluded parts
  - Example: Single ETP with excluded and non-excluded parts, and unused leave payments

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Example: Including taxable income in the whole-of-income cap

In August 2016, Tyrone is terminated from his job and receives a $100,000 gratuity and $20,000 for accrued leave. He also receives $5,000 in salary for the period from 1 July 2016 to the date of termination.

Tyrone's whole-of-income cap is reduced from $180,000 to $155,000 because he received $25,000 salary and accrued leave payment.

Because Tyrone has not reached his preservation age, his employer withholds 32% in tax from the $100,000 ETP. Tyrone's employer gives him a PAYG payment summary – employment termination payment showing:

- Total tax withheld: $32,000
- Date of payment: 15 August 2016
- Taxable component: $100,000
- Tax-free component: Nil
- ETP code: **O**.

Tyrone gets a new job in September 2016 and earns a further $60,000 salary in the 2016–17 income year.

When calculating the tax on Tyrone's ETP at the end of the income year, his calculated whole-of-income cap is further reduced to $95,000 – that is, $180,000 less:

- $5,000 salary from his first job
- $20,000 accrued leave payment
- $60,000 salary from his second job.

As Tyrone's ETP of $100,000 is greater than his whole- of- income cap of $95,000, an amount of $5,000 will be taxed at the highest tax rates (49% in the 2016-17) when he submits his tax return. Tyrone will need to pay an additional 17% tax on the $5,000 (49% minus the 32% already withheld by his employer). As a result, Tyrone will have a tax debt of $850.

Tax losses and the whole-of-income cap

Tax losses are not taken into account in working out the whole-of-income cap.

Example: ETPs and tax losses

Mike retires on 1 July 2016 and receives an ETP of $200,000. The ETP is subject to the whole-of-income cap of $180,000. Mike's employer withholds at concessional tax rates from $180,000 of the ETP, and at the highest tax rate (49% in 2016–17) from the $20,000 that is above the cap.

Mike has some negatively geared investments. He has a tax loss of $20,000 and a nil taxable income (not including ETPs) in 2016–17.

Mike’s whole-of-income cap remains at $180,000 because his taxable income is nil.

Next steps:

- Multiple payments
- Withholding and payment summaries

Multiple payments

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=9 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=9)
- Last modified: 28 Mar 2017
- QC 26218

Both the whole-of-income cap and the ETP cap are reduced by earlier life benefit ETPs paid to the employee in the same income year, even if they are for different terminations.

In addition, the ETP cap is reduced by earlier life-benefit ETPs paid for the same termination, even if the payments are in different income years.

These reductions affect the caps for:

- an ETP paid in instalments
- multiple ETPs
- a single ETP that includes excluded and non-excluded payments.

The death benefit ETP cap amount is independent of the life benefit ETP cap amount. Payments that count towards one cap don't count towards the other.

ETP paid in instalments

You may choose to pay an ETP in instalments. For payments made after the initial payment, the cap amount is reduced by the previous payment or payments for the same termination that counted towards the cap.

Example: ETP paid in instalments

Craig retired from his job in a law firm in December 2016 and received a termination payment of $100,000 paid in two instalments – $50,000 in December 2016 and $50,000 in June 2017. At the time he retired, he had taxable income from wages of $95,000.

Craig's ETP was a non-excluded termination payment that is subject to the lesser of the ETP cap and whole-of-income cap.

His whole-of-income cap ($180,000) is reduced to $85,000 – that is, $180,000 minus $95,000 taxable income from wages – while his ETP cap is $195,000 (for 2016–17). The whole-of-income cap will apply because it is the lesser of the two caps.

Craig's first payment of $50,000, received in December 2016, is less than the calculated whole-of-income cap of $85,000 and will be concessionally taxed. His whole-of-income cap is now further reduced to $35,000 – that is, $85,000 minus the

$50,000 termination payment.

For the second payment of $50,000, received in June 2017, only $35,000 falls within the calculated whole-of-income cap and is taxed at a concessional rate. The remaining $15,000 is taxed at the highest tax rate (49% in 2016–17).

Multiple ETPs

The ETP cap is reduced by earlier life benefit ETPs for the same termination, even if they are paid in different income years. This prevents splitting payments to avoid the ETP cap.

The ETP cap is also reduced by any earlier ETP received in the same income year, even if it is for a different termination.

Example: Multiple ETPs

Lloyd's employment is terminated in June 2016 and he receives a $100,000 ETP. His final entitlements are calculated and a second ETP, also for $100,000, is paid in August 2016.

Both payments are excluded payments that are subject only to the ETP cap.

The first ETP is less than the ETP cap (/Rates/Schedule-11---Tax-table-for-employment-termination-payments/?page=2#ETP_caps) ($195,000 in 2016–17) and is concessionally taxed.

Lloyd’s ETP cap for the second ETP paid in 2016–17 is only $95,000 because it is reduced by the earlier ETP for the same termination – that is, $95,000 minus $100,000.

As a result, $5,000 – that is, the $100,000 ETP minus $95,000 – will be more than the reduced ETP cap and taxed at the highest tax rate (49% in 2016–17).

Single ETP with excluded and non-excluded payments

A single ETP may contain both:

- an excluded part (for example, a genuine redundancy payment) that is subject solely to the ETP cap, and

- a non-excluded part (for example, a gratuity) that is subject to the lesser of the ETP cap and whole-of-income cap.

The excluded part is taken into account first, then the non-excluded part:

- Apply the ETP cap to the excluded part.
- Apply the lesser of the remaining ETP cap and the whole-of-income cap to the non-excluded part. When calculating the whole-of-income cap, the employee's taxable income does not include the taxable component of the excluded part.

You'll need to issue two ETP payment summaries – one for the excluded part and one for the non-excluded part.

Example: Single ETP with excluded and non-excluded parts

Robyn receives a single ETP of $170,000 in 2016–17. It consists of two parts:

- $120,000 compensation for unfair dismissal – this is an excluded payment that is subject to the ETP cap only
- a $50,000 gratuity – this is a non-excluded payment that is subject to the lesser of the whole-of-income cap and ETP cap.

Robyn also earned $20,000 in salary and wages.

Even though the two parts are in the one ETP, the excluded part is taken as being received first. The entire $120,000 of her compensation payment is an excluded payment and is taxed at a concessional rate because it is less than the ETP cap.

The balance of the ETP cap is $75,000 ($195,000 for 2016–17, minus $120,000).

The gratuity part of Robyn's ETP is subject to the lesser of the two caps. Robyn's calculated whole-of-income cap is $160,000 ($180,000 reduced by her $20,000 salary).

Because Robyn's ETP cap ($75,000) is the lesser of the two caps, it applies to her $50,000 gratuity. All of Robyn's gratuity will receive concessional tax treatment.

Next step:

- Withholding and payment summaries

Withholding and payment summaries

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=10 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=10)
- Last modified: 28 Mar 2017
- QC 26218

You need to:

- withhold from the taxable component of the ETP at the correct rate (the rate depends on the applicable cap and, for life benefit ETPs, whether the employee has reached their preservation age)
- enter the appropriate codes on the employee's ETP payment summary (to confirm the correct rate of tax has been applied)
- give the payment summary to the employee within 14 days of paying the ETP.

To work out the employee's preservation age, the amount to withhold and the codes to enter on the employee's payment summary, see:

- Tax table for employment termination payments (/Rates/Schedule-11---Tax-table-for-employment-termination-payments/?page=5#Table_A__Withholding_rates_for_ETPs)

You can use the ETP payment summary paper form available from the ATO, or an equivalent payment summary produced by your payroll software.

See also:

- PAYG payment summary – employment termination payment (/Forms/PAYG-payment-summary---employment-termination-payment-from-1-July-2012/)
- Amending a payment summary
- The 12-month rule

Example: Single ETP with excluded and non-excluded parts, and unused leave payments

After five years' service, Alec, who is 30 years old, is made redundant from his place of work in 62016–17 and receives the following payments in his termination pay:

- redundancy pay – $34,500.00
- unused sick leave – $6,178.50
- payment in lieu of notice – $1,723.42
- unused annual leave – $5,234.17
- unused long service leave – $11,423.91

- gratuity – $25,000.00.

Under Alec's workplace agreement, payment in lieu of notice, and the gratuity, are payable on termination of employment – this means they are paid for any type of departure, including voluntary termination. Alec's employer has contacted us and confirmed that his redundancy meets the conditions of a genuine redundancy – this means the redundancy payment and unused sick leave payment are in excess of what was reasonably expected to be paid for a voluntary termination.

The redundancy payment and unused sick leave payment are excluded payments and the ETP cap only applies. The payment in lieu of notice and gratuity are non-excluded payments, and the lesser of the ETP cap and whole-of-income cap applies.

Alec had previously received $140,000 in other taxable payments (salary and wage income) during the income year.

Table: Steps to work out how Alec's termination pay is taxed

Step	Action	Result
1	Calculate the genuine redundancy payment The redundancy payment and unused sick leave qualify as genuine redundancy: $34,500 + $6,178	$40,678
2	Calculate the tax-free limit on the genuine redundancy payment The tax-free amount in 2016–17 is $9,936 + $4,969 for each completed year of service. Alec has five years of completed service: $9,936 + (5 × $4,969) Note: The result is shown at label D on a PAYG payment summary – individual non-business	$34,781

3	Calculate the taxable component of the genuine redundancy part of the payment This is the genuine redundancy payment from step 1 minus the tax-free limit amount from step 2: $40,678 − $34,781 Note: The result is shown at Taxable component on a PAYG payment summary — employment termination payment with ETP code R. Because this part of the termination payment is an excluded payment, only the ETP cap applies. Alec is under the preservation age and the excluded payment of $5,897 will be taxed at 32%.	$5,897 ETP code R
4	Calculate the remaining ETP cap This amount is the ETP cap ($195,000 for 2016–17) minus the taxable component of the excluded payment (from step 3): $195,000 − $5,897	$189,103
5	Calculate the non-excluded payment The non-excluded part of the termination payment is the payment in lieu of notice and the gratuity: $1,723 + $25,000 Note: The result is shown at Taxable component on a separate PAYG payment summary – employment termination payment with ETP code O.	$26,723 ETP code O
6	Calculate the whole-of-income cap This is the whole-of-income cap of $180,000 minus other taxable income: • $140,000 salary and wage income • $16,657 for unused annual and long service leave The whole-of-income cap is not reduced by the excluded part of the termination payment because it was received at the same time as the non-excluded payment – that is, it was not received earlier in the income year.	$23,343 (Calculated whole-of-income cap)
7	Determine the lesser of the ETP caps Alec's non-excluded payment will be subject to the lesser of the remaining ETP cap or the whole-of-income cap: • Remaining ETP cap (from step 4) $188,557 • Calculated whole-of-income cap (from step 6) $23,343	$23,343 (Calculated whole-of-income cap is the lesser cap)

8	Apply the calculated whole-of-income cap to the non-excluded payment The non-excluded payment ($26,723, from step 5) is taxed concessionally up to the calculated whole-of-income cap of $23,343. The remainder of the non-excluded payment ($26,723 – $23,343 = $3,380) is above the whole-of-income cap and is taxed at the highest tax rate (49% in 2016–17).	$23,343 taxed at 32% $3,380 taxed at 49%

Alec's payments for unused annual and long service leave totalling $16,657 are not part of his ETP. They are taxed separately and reported on his PAYG payment summary – individual non-business. See Accrued leave.

Amending a payment summary

If there is a mistake with any amount or ETP code in the payment summary given to the employee or the ATO, you should complete a new payment summary, entering X in the box amending a payment summary.

If there is a change in circumstances and you have not yet issued the payment summary or lodged your PAYG withholding annual report, you can complete the payment summary according to the updated circumstances.

For example, if an employee retires from their position on a certain date, and that former employee dies before the payment summary is issued, then the payment and payment summary should be completed as a death benefit ETP.

The 12-month rule

- https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=11 (https://www.ato.gov.au/Business/Your-workers/In-detail/Taxation-of-termination-payments/?page=11)
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To receive concessional tax treatment an ETP must generally be paid within 12 months of termination.

Payments outside the 12-month period are included in the recipient's assessable income and taxed at their marginal tax rates.

The 12-month rule does not apply to the taxable component of genuine redundancy payments and early retirement scheme payments.

A payment that is made more than 12 months after termination can still be treated as an ETP in any of the following circumstances:

- the delay is due to legal action that began within 12 months of the termination, provided the legal action concerned the entitlement to the payment or the amount of the entitlement
- the payment is made by a liquidator, receiver or trustee in bankruptcy of an entity that was otherwise liable to make the payment and the date of appointment of the liquidator, receiver or trustee is no later than 12 months after the termination of employment
- a payment is received from a redundancy trust in some cases.

See also:

- Employment Termination Payments (12 month rule) Determination 2007 (/law/view/document?docid=ITD/SPR20071/00001)
- Employment Termination Payments Redundancy Trusts (12 month rule) Determination 2009 (http://www.comlaw.gov.au/Details/F2009L00716) .