



## MEMBERS INFORMATION SHEET

# PURCHASED LEAVE - SOME CONSIDERATIONS

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### WHAT IS PURCHASED LEAVE?

Purchased leave is an additional benefit that some employers choose to offer to their employees. It is a voluntary arrangement where employees can choose to take part in a scheme which allows them to purchase additional paid leave.

It is important to note that **purchased leave is not covered by legislation**. This means there are no specific rules or requirements for a purchased leave scheme, as long as scheme does not breach the Fair Work Act, superannuation legislation or an award/agreement.

The terms and conditions of the scheme are therefore contained in the employer's policy and/or the written agreement entered into by the employee. If you haven't covered a particular situation in your policy, then you will most likely have to come to agreement with the employee as to how to handle issues as they arise.

### INITIAL CONSIDERATIONS

#### How much leave can employees purchase?

Most schemes include a limit on how much can be purchased (eg 1 weeks, 2 weeks, 4 weeks). The employer should consider how much time employees can spend away from the business each year without having an operational impact.

#### Over what period of time will the arrangement take place?

Often these schemes run over a 12 month period, but it could be any period agreed between employer and employee.

#### Can employees join the scheme at any time?

Will your employee only be able to join at certain time of the year (eg Nov/Dec for a scheme which runs Jan-Dec) or will employees be able to join at any time? Will there be any exceptions or discretion around this in your policy?

#### Which employees will be eligible to participate in the scheme?

Will you allow all employees to participate or will there be eligibility criteria such as:

- Length of service – eg passed probation
- Current leave balances eg low annual leave and/or LSL balance
- Operational considerations – eg only some departments or subject to approval by the employee's manager

#### When must the leave be taken? And what happens if the purchased leave is not taken in full by the end of the purchased leave period?

Often the policy requires that the leave be taken with a certain period (eg 12 months). The policy should also address what will happen if the employee doesn't take the leave during the agreed period of time.

### ACCRUING PURCHASED LEAVE

Another initial consideration is determining how the employee will accrue the additional leave purchased. This should be clearly set out in your policy. For example, the leave could accrue:

1. Immediately upon entering into the purchased leave arrangement;
2. Gradually over the period of the purchased leave scheme (on hours worked or time elapsed);
3. Only once the leave has been fully funded by the employee; or
4. Any other options agreed between employer and employee.

## How will you track the amount of purchased leave an employee has available, in your payroll system?

We recommend setting up a separate leave code for this, rather than adding it to the employee's annual leave balance. Purchased leave is not annual leave. It is a separate entitlement and there are times when they may need to be distinguished.

## PURCHASING ARRANGEMENTS

There are 3 common ways employee can purchase or pay for the additional leave:

- Salary sacrifice (pre-tax deduction);
- Reduced annual salary; or
- Post tax deductions.

### Salary sacrifice

The most common way employees "purchase" the additional leave is through a salary sacrifice arrangement. To do this you would work out the value of the leave being purchased and then distribute the cost over the agreed period.

### Reduced salary

A less common way to purchase leave is by a reduction in overall annual salary (more common in the public sector). Employers may require that employees seek independent financial advice under this type of scheme as it may result in less super being paid. This method can be particularly complex if you have employees engaged under an award or agreement.

### Deduction from net pay

The leave could also be purchased through a post-tax deduction from the employee's net pay. The fortnightly salary deductions are then set aside by the employer and accessed by the employee during the period of purchased leave. Under this scheme employee is often said to be on LWOP when taking the purchased leave rather than on paid leave.

## TAKING PURCHASED LEAVE

### Does leave accrue when the employee is absent on purchased leave?

Yes, as a general rule, leave accrues when an employee is absent on any type of authorised paid leave. This would include purchased leave.

### Do we need to pay leave loading on purchased leave?

No, unless your policy says otherwise, leave loading is not usually payable on purchased leave. Purchased leave is not annual leave. The policy should make this clear to avoid any confusion.

### Does purchased leave count as service?

As it is paid leave authorised by the employer, purchased leave counts as service.

### How can the purchased leave be taken?

Your policy will determine if the employee can take the leave in blocks, part days, on half pay etc.

## SUPERANNUATION AND PURCHASED LEAVE

If you are operating under a reduced annual salary arrangement, this may result in less super being payable to an employee and we therefore recommend getting legal advice to ensure you are compliant with all legal requirements.

If you are operating a post-tax deduction scheme, then the post-tax deduction will have no impact on the employee's superannuation.

Under a salary sacrifice scheme, there are two ways we usually see the super processed:

### Option 1:

Superannuation is paid on the employees reduced pay (after the salary sacrifice) each pay period and then super is paid when the employee takes the purchased leave.

### Option 2:

Superannuation is paid on the employee's full salary (before the salary sacrifice) and no super is paid when the employee takes the purchased leave.

We recommend **Option 1**. This is because paid leave is generally considered OTE so we would expect to see super paid when the employee takes the leave. Paying super on the reduced pay is compliant with ATO requirements.

## LWOP & PAY RATE CHANGES

### What happens if an employee takes LWOP during the purchased leave period?

Your policy should address what will happen if an employee takes enough LWOP that the full deduction amount cannot be made in a pay period.

For example, if the employee is only taking a small amount of LWOP, this might be handled by an increased deduction in the next pay period. However, if a longer period of LWOP is being taken, the policy might allow for purchased leave agreement to be terminated by the employer, with any leave remaining refunded or any amount owing repaid.

### What happens if the employee's pay rate changes (increases or decreases) during the purchased leave period?

Again this should be addressed in your policy. For example, it might allow for:

- A change to the deduction amount going forward (but no adjustment to the deductions already made); or
- A new annual calculation to be done (including any leave that has been taken to date) with an increased/decreased deduction based on the new total cost of the purchased leave.

## TERMINATION DURING THE PURCHASED LEAVE PERIOD

What happens if the employment terminates before the end of the purchased leave period?

You would perform a reconciliation of purchased leave accruals and deductions made as at the date of termination and:

- If employee has leave owing – this must be paid out on termination
- If employee has already taken leave –deducting any amount owing from their final pay should be addressed in the purchased leave agreement signed by the employee.

### How do you tax unused purchased leave on termination?

There is nothing in the ITAA that deals specifically with purchased leave. However, based on the wording ITAA sect 83.10 we believe it will be taxed and reported the same as annual leave. (We are waiting on ATO confirm of this.)

### What if the purchased leave scheme needs to end early?

Your policy should address in what circumstances and employer or employee can terminate the purchased leave arrangement early and also what will happen if this occurs. We recommend including in the initial agreement the authority to deduct any amounts owing.

If you need to pay out any unused purchased leave to the employee it would be taxed under Schedule 5 (as a lump sum payment like a bonus).