Administrative Appeals Tribunal

DECISION AND REASONS FOR DECISION

JSJG and Commissioner of Taxation (Taxation) [2019] AATA 336 (7 March 2019)

Division: TAXATION AND COMMERICAL DIVISION

File Number: **2017/1971**

Re: **JSJG**

APPLICANT

And **Commissioner of Taxation**

RESPONDENT

DECISION

Tribunal: **Senior Member R. Pintos-Lopez**

Date: **7 March 2019**

Place: **Melbourne**

The Tribunal sets aside the decision under review and remits it to the Respondent with the finding that the lump sum payment of $803,000 is not assessable to the Applicant in the income year ended 30 June 2016.

.[SGD].....

Senior Member R. Pintos-Lopez

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Catchwords

TAXATION – capital gains tax – whether there is a CGT exemption – private ruling settlement sum provisions – settlement release agreement – whether sum relating directly to compensation – whether compensation for the taxation consequences of the receipt of a lump sum instead of payments on a monthly basis – total permanent disability payment as capital in nature – decision set aside

Legislation

Income Tax Assessment Act 1997 (Cth)

Taxation Administration Act 1953 (Cth)

Cases

Commissioner of Taxation v McMahon (1997) 79 FCR 127

Sommer v Federal Commissioner of Taxation (2002) 51 ATR 102

Rosgoe Pty Ltd Commissioner of Taxation [2015] FCA 1231

Cooper Bros Holdings Pty Ltd trading as Triple R Waste Management v Commissioner of Taxation (2013) 93 ATR 324

Commissioner of Taxation v McMahon (1997) 79 FCR 127

Federal Commissioner of Taxation v Dixon (1952) 86 CLR 540

Carapark Holdings Ltd v Federal Commissioner of Taxation (1967) 115 CLR 653

Commissioner of Taxes (Vic) v Phillips (1936) 55 CLR 144

Sydney Refractive Surgery Centre Pty Ltd v Commissioner of Taxation [2008] FCA 454; (2008) 70 ATR 874

Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation (1989) 20 FCR 288

McLaurin v Federal Commissioner of Taxation (1961) 104 CLR 381

Allsop v Federal Commissioner of Taxation (1965) 113 CLR 341

Dibb v Commissioner of Taxation (2004) 136 FCR 388

Purvis v Federal Commissioner of Taxation (2013) 90 ATR 739

REASONS FOR DECISION

Senior Member R. Pintos-Lopez

7 March 2019

1. The Applicant applies for review of a decision made by the Commissioner of Taxation (the **Commissioner** or **Respondent**) on 27 January 2017 (the **Decision**) to disallow his objection to a private binding ruling made on 17 August 2016 (the **Ruling**). The effect of the Ruling was that a lump sum payment of $803,000, made to him by his insurers to settle claims made against the insurers was fully assessable to him in the income year ended 30 June 2016.

2. For the reasons set out below, the Decision is set aside and remitted to the Respondent, with the finding that the lump sum payment of $803,000 is not assessable to the Applicant in the income year ended 30 June 2016.

3. A second question was posed by the Applicant: whether the $803,000 is exempt from capital gains tax (**CGT**) under s 118-37(1)(a) of the *Income Tax Assessment Act 1997* (Cth) (the **ITAA**) because the sum is a capital gain relating directly to compensation or damages for a wrong, injury or illness suffered by the Applicant personally. I find that the lump sum payment is not exempt from CGT under s 118-37(1)(a) of the ITAA.

I. THE PRIVATE RULING PROVISIONS

4. The Applicant seeks review of a private ruling and, as a result, various rules apply to the review, including that the relevant facts are limited to those facts set out in what is referred to as the "arrangement" or the "scheme".

5. In *Commissioner of Taxation v McMahon* (1997) 79 FCR 127, Lockhart J (Beaumont and Emmett JJ agreeing with his Honour's orders) stated:

> *If a taxpayer seeks a review of the private ruling before the Tribunal, the subject matter of that review is the arrangement as identified by the Commissioner in his private ruling. That arrangement is constant throughout the process of the private ruling and any review or appellate process that ensues. The Tribunal may form its opinion as to how the tax law operated or would operate on the facts that constitute the arrangement; and it may disagree with the Commissioner and alter*

the objection decision. But the review is not a review in the usual sense that applies to the processes of administrative review when it is dealing with actual facts. These are hypothetical facts. They may turn out to be the real facts; but the whole notion of a private ruling is that the facts are not necessarily the facts that will underlie the making of any ultimate assessment. If the factual matrix as explained to the Commissioner in aid of a request for a private ruling are suspicious, the Commissioner has ample powers to decline to make a private ruling. Once the ruling is made, it is made with respect to the facts that are identified for the purposes of the private ruling itself.

In my opinion on a process of review the Tribunal cannot redefine the arrangement. The Tribunal is limited to the facts that constitute the arrangement as identified by the Commissioner in his own ruling.[1]

6. More broadly as to the private ruling provisions, his Honour stated:

> *The private ruling provisions were introduced to assist taxpayers who are uncertain about the tax effect of an arrangement that is proposed, commenced or completed and who wish to obtain a ruling from the Commissioner on this question before the assessment process is complete. It enables taxpayers to order their affairs with a degree of certainty about their tax implications before they embark or whilst they are embarking, upon courses of conduct, the tax implications of which may not be known for a considerable time. Private rulings may be sought upon facts which may turn out to be not the true facts at all. In that sense they may be sought upon hypothetical facts.*[2]

7. Division 359 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) concerns private rulings.[3]

8. Section 359-5 of the *Taxation Administration Act 1953* provides:

> *(1) The Commissioner may, on application, make a written ruling on the way in which the Commissioner considers a relevant provision applies or would apply to you in relation to a specified *scheme. Such a ruling is called a **private ruling**.*
>
> *(2) A *private ruling may cover any matter involved in the application of the provision.*

9. Section 359-60 deals with objections to private rulings and provides, in part:

> *(1) You may object against a *private ruling that applies to you in the manner set out in Part IVC if you are dissatisfied with it.*

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1 Pages 132-133. See also, *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102, at [4] Merkel J stating "It is common ground that the AAT is confined and limited to the facts ruled upon by the Commissioner and that the court is likewise confined and limited." See *FCT v McMahon* (1997) 79 FCR 127.

2 Page 133.

3 See sections 357-5, 357-60, 357-115 (additional information), 359-5, 359-10, 359-60.

(2) The ruling is taken to be a taxation decision (within the meaning of that Part).

10. Section 359-65(1) provides that, in deciding whether to allow or to disallow an objection against a private ruling, the Commissioner may consider any additional information that the Commissioner did not consider when making the ruling.

11. Section 359-65(3) provides that if the Commissioner considers that the additional information is such that the scheme is materially different from the scheme to which the ruling relates, the Commissioner must request that the applicant make an application for another ruling and the objection is taken not to have been made.

12. In *Rosgoe Pty Ltd Commissioner of Taxation* [2015] FCA 1231, Logan J stated:

> *On a review of an objection decision in respect of a private ruling, the Tribunal is not permitted to redefine the "arrangement" as stated by the Commissioner in his ruling. Put another way, the Tribunal may not itself engage in a fact finding exercise. Rather, the Tribunal must form its own view as to how a taxation law applies to an arrangement it takes as a given.* [4]

13. In *Cooper Bros Holdings Pty Ltd trading as Triple R Waste Management v Commissioner of Taxation* (2013) 93 ATR 324, Deputy President Alpins, after reviewing the authorities, considered that the Tribunal may take certain additional information into account that is informative about the facts comprising the factual scheme.[5]

II. THE SCHEME

14. The Applicant applied for a private ruling in relation to a settlement sum he received under a release agreement, dated 13 May 2016, between the Applicant and Zurich Australia Limited (**ZAL**) and Zurich Australian Superannuation Pty Limited (**ZAS**) (the **Release Agreement**). The Release Agreement concerned claims made by the Applicant against ZAL and ZAS in relation to income replacement benefits under an income protection policy and total and permanent disability (**TPD**) payments, under a term life insurance policy.

15. The scheme is set out in the Ruling:

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4 [12] (citing Lockhart J in *Commissioner of Taxation v McMahon* (1997) 79 FCR 127.)

5 The Respondent in his submissions agreed with the proposition as expressed in *Cooper Bros Holdings.*

You had income protection insurance with Zurich Australia Limited (ZAL) and term life insurance with Zurich Australian Superannuation (ZAS).

You sustained a workplace injury.

You were found to be totally and permanently disabled (TPD).

You have and continue to suffer from symptoms of acquired brain injury, depression, anxiety and post-traumatic stress disorder.

ZAL paid you the sum of $1,100,000 (one million one hundred thousand dollars) gross and all inclusive of any applicable taxes, costs and interest (the settlement sum).

The parties agreed the Settlement Sum was to be paid as follows:

(i) in so far as the Proceeding relates to the TPD Claim, ZAL will pay to ZAS the sum of $297,000 (two hundred and ninety seven thousand dollars) gross and all inclusive of any applicable taxes, costs and interest ('the TPD agreed Sum'), to be preserved for the Releasor in the Fund in accordance with the trust deed and rules incorporating the Fund and the Superannuation Industry (Supervision) Act 1999 (Cth) and any applicable regulations (the SIS Act and Regulations'); and

(ii) ZAL will pay the balance of the Settlement Sum, being the sum of $803,000 (Eight hundred and three thousand dollars) gross and all inclusive of any applicable taxes, costs and interest ('the Balance Agreed Sum') to the Releasor.

You signed the release agreement on 15 March 2016.

A. Release Agreement

16. The Release Agreement states that the parties have agreed to settle litigation commenced by the Applicant, on or around October 2013, on the terms outlined in the release. The Release Agreement contains the terms for payment and the settlement sum referred to in the scheme.

17. The recitals, among other things, provide:

*E. On or about 7 July 2011 the Releasor lodged a claim for income protection benefits ('IP benefits') under the IP Policy alleging that be had ceased 'work as a disability support carer in or around March 2011 ('the **IP Claim'**),*

F. Zurich paid IP benefits and premium refunds to the Releasor for the period from on or about 21 May 2011 to 29 July 2012 totalling approximately $70,412,28.

G. The claim was subsequently finalised and ZAL has not paid any further benefits to the Releasor under the IP Policy beyond 20 July 2012.

…

I. *On or about 26 February 2013, the Releasor lodged a claim for a TPD benefit pursuant to the terms of the TPD Policy end the trust deed and rules constituting the Fund (the **TPD Claim' end collectively with the IP Claim described as 'the Claim'**).*

…

O. *The **Releasor commenced** proceedings in the County Court of Victoria being case number CI-13-05096, naming ZAL and ZAS as the first and second defendants **in respect of the Claims and the TPD Claim respectively, more fully particularised in the Statement of Claim** filed on 3 October 2013 and the amended Statement of Claim filed pursuant to the orders of his Honour Judge Misso dated 5 May 2014 (the Proceeding).*

…

R. *It has been agreed between the parties to this release, without admission of liability by any party, to settle on terms as outlined in this release.*

(Emphasis added)

18. The recitals refer to the "Income Replacement Insurance Plus Policy" (the **IP policy**),[6] which was issued to the Applicant (referred to as the Releasor in the Release Agreement). In addition, ZAS is stated to have effected a policy (the "Superannuation Term Life Insurance Plus – Zurich Superannuation Plan" (the **TPD policy**))[7] with ZAL, which names ZAS as the policy owner, and the Applicant as the life insured.

19. Clause 1 is entitled "Consideration" and, in part, provides:

> *Without admission of liability by any party to this release and **in consideration of the undertaking and covenants provided** in this, the parties to this release agree to the following terms;*
>
> *(a)* *The **Releasor will discontinue the Proceeding** as against the Releasees;*
>
> *(b)* *Subject to clauses 1(c) to 1(f) of this release, ZAL will pay the sum of $1,100,000 (One Million and One Hundred Thousand Dollars) gross and all inclusive of any applicable taxes, costs and interest ('the Settlement Sum').*
>
> *(c)* *The parties agree **the Settlement Sum is to be paid as follows**:*
>
> *(i)* ***In so far as the Proceeding relates to the TPD Claim,** ZAL will pay to ZAS the sum of **$297,000** (Two Hundred and Ninety Seven*

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6 I assume that the use of "IP" in abbreviating the policy is because it is "Insurance Plus" or refers to "income protection". Otherwise, it would have been more logical to refer to it as the "IR" policy.

7 The policies are abbreviated in the manner of the Release Agreement for ease of consistent reference across the various documents referred to herein.

Thousand Dollars) gross and all inclusive of any applicable taxes, costs and interest ('the TPD Agreed Sum'), to be preserved for the Releasor in the Fund in accordance with the trust deed and rules incorporating the Fund and the Superannuation Industry (Supervision) Act 1999 (Cth) and any applicable regulations ('the SIS Act and Regulations'); end

*(ii) ZAL **will pay the balance of the Settlement Sum**, being the sum of **$803,000** (Eight Hundred and Three Thousand Dollars) gross and ail inclusive of my applicable faxes, costs and Interest ('the Balance Agreed Sum) to the Releasor.*

…

(i) No party shall at any time in the future be held accountable under any term of the IP Policy, the TPD Policy. the Subsequent Related Policies and/or the Former TPD Policy (collectively referred to in this release as 'the Zurich Policies'), The parties agree that no money already paid under the Zurich Policies will be repaid.

(Emphasis added.)

20. Clause 1(c) mirrors the wording contained in the scheme.

21. Clause 2 contains the releases and provides:

*The **Releasor releases and discharges the Releasees** from all actions, suits, claims, demands, causes of action, costs and expenses, legal, equitable, under statute end otherwise, and ell other liabilities of any nature (whether or not the parties were or could have boon aware of them) which the Releasor;*

(a) now has;

(b) at any lime had;

(c) may have; or

(d) but for this release, could or might have had,

*against the Releasees in any way **related to the Proceeding, the Claims, the Zurich Policies** or the circumstances recited to this release or allegations arising out of or in any way related to the Proceeding, the Claims, the Zurich Policies and in the circumstances recited in this release or anything in any way related to them.*

B. The Proceeding and the Amended Statement of Claim

22. The settlement sum referred to in the scheme is, as noted above, referrable to the Release Agreement, which in turn provides that the settlement sum is paid in consideration of the undertaking and covenants in the release; including, at clause 1(a) of the Release Agreement, the Applicant discontinuing the "Proceeding".

23. The release itself, at clause 2 of the Release Agreement, is more broadly worded to include release from all forms of claims which the Applicant has, or may have, against ZAL and ZAS in any way related to the "Proceeding, the Claims, the Zurich Policies".

24. The pleadings in respect of the proceeding are referred to in the Release Agreement, at recital O, and, relevantly, include the Amended Statement of Claim (the **Statement of Claim**).

25. The Statement of Claim sets out the IP policy and various terms before stating, at paragraph 5, that from March 2011 onwards, the Applicant was unable to earn his pre-disability income from his usual occupation. In relation to this last fact, the Statement of Claim provides further particulars, stating that from late 2008 the Applicant was employed as a carer in an accommodation support service; and that from May 2010 he suffered from severe headaches; and that again in March 2011 he experienced severe and frequent headaches and also symptoms of post-traumatic stress. Further, the Statement of Claim provides that he ceased work in March 2011; and that he had attempted to continue in other roles but was unable to return to work due to his disability.

26. The Statement of Claim states that the Applicant claimed a benefit in around July 2011, which was paid until around July 2012. The Applicant claims that, in breach of the IP policy, ZAL has failed to pay the Applicant and waive the premium from July 2012. Paragraph 11 provides:

> *In breach of the policy, the First Defendant failed to:*
> *(a) pay to the Plaintiff the Income Benefit;*
> *(b) waive premium*
> *for the period 29 July 2012 to date and continuing.*

27. Importantly, the Statement of Claim provides at paragraph 12 "in the alternative to paragraph 11 above, in the premises, the Plaintiff suffered loss and damage". The particulars to paragraph 12 are important to the Applicant's current application; it sets out claims for:

> *Loss of benefits under the policy.*
>
> *Loss of premium.*
>
> *Compensation for the taxation consequences of the receipt of a lump sum instead of payments on a monthly basis.*

Further, inconvenience, mental anguish, personal insecurity and distress suffered by the Plaintiff as a result of his loss of money and financial security.

(Emphasis added)

28. The Statement of Claim then sets out the claim for TPD under the TPD policy, which is not relevant to the application.

29. The Statement of Claim concludes:

AND THE PLAINTIFF CLAIMS

Against the First Defendant:

A. The monthly Income Benefit payable pursuant to the policy referred to in paragraph 2 above for die period 29 July 2012 to date and continuing.

B. Repayment of premium paid for the period 29 July 2012 to date and continuing.

C. Further or alternatively, damages pursuant to paragraph 12 above.

CA. The Total and Permanent Disablement benefit under the TPD policy referred to in

Against the Second Defendant:

CB. The Total and Permanent Disablement benefit under the Rules referred to in paragraph 13 above.

Against both Defendants;

D. Interest pursuant to statute.

E. Costs.

F. Such other or further Order as this Honourable Court deems fit.

(Emphasis added.)

30. In terms of the amounts involved in the claims and the settlement, the Commissioner refers to, and relies upon, an email from Mr R K, who acted as an accountant for the Applicant, to Ms R C, a review officer at the Australian Taxation Office, dated December 2016, which provides in answer to an earlier email from Ms R C:

I am attaching the amended statement of claim which incorporates the synopsis of policy ***<redacted>.*** *You will notice that paragraph 2 records that the lawyers have a copy of that policy and am contacting them to obtain the document. In addition, I will request from them, if available, the basis of calculation and will refer as soon as the information is to hand. I will request, if possible, a declaration should your requests not be able to be met.* ***We have been previously verbally advised that the settlement was an negotiated amount and has no basis of calculation.***

On a historical basis, with reference to the Zurich repudiation letter, benefits would be payable till 10th July, 2042 (see amended statement of claim 3(s)), which

> ***amounts to 30 years @ a monthly payment of $5667.97*** *- Gross $2,040,469 (Excluded indexation in terms of the policy) Add to this the TPD policy $ 738,729 (see amended statement of claim 14). Total $2,779,198. The repudiation letter sets out Zurich reasons.* ***The figures calculated were taken into consideration at arriving at a settlement.***
>
> (Emphasis added.)

C. The questions

31. The Ruling posed and answered the following questions:

> *Does the Total and Permanent Disablement (TPD) payment form part of your taxable income?*
>
> *No.*
>
> *Is the total lump sum amount you receive in full and final settlement of your claim under an income protection policy assessable income?*
>
> *Yes.*

32. This application does not concern the first issue as to the TPD payment. Rather, the Applicant seeks review of the decision that the lump sum payment of $803,000 made to him by his insurers to settle his claims was fully assessable to him in the income year ended 30 June 2016.

33. Accordingly, the Decision, which concerned the Applicant's objection, was posed as follows:

> *Should your assessable income include the settlement sum, received under your release agreement executed in an out-of-court settlement of legal proceedings for claims against Zurich Australia Limited and Zurich Australian superannuation Pty Limited?*
>
> *Answer*
>
> *Yes, to the extent it was paid with respect to the replacement of income.*

34. The Applicant submits, principally, that the payment is a single undissected lump sum which cannot be dissected into two distinct amounts applicable to the TPD claim and the income protection policy claim. If the Applicant is correct, then on the basis of legal authority, the whole payment is to be treated as capital in nature and does not form part of the Applicant's assessable income.

35. The Applicant, in his submissions, poses a further question: Is the lump sum amount of $803,000 exempt from CGT under s 118-37(1)(a) of the ITAA because the sum is a

capital gain relating directly to compensation or damages for a wrong, injury or illness suffered by the Applicant personally? The Applicant submits that s 118-37(1)(a) applies.

36. An issue arises as to the Tribunal's capacity to answer that question in circumstances where neither the Decision being reviewed nor the Ruling directly poses or answers that question. Having regard to the Decision, I accept that I am able to answer this second question as it is sufficiently addressed in the Decision, because the reasons note that the Applicant had argued that s 118-37(1)(a) applied, and the reasons refer to that question in the course of a consideration of the issues.

37. The issues are considered below as follows - whether the lump sum of $803,000 paid to the Applicant under the Release Agreement is:

    (a) assessable income of the Applicant in the 30 June 2016 income year;

    (b) exempt from CGT under s 118-37(1)(a) of the ITAA because the sum is a capital gain relating directly to compensation or damages for a wrong, injury or illness suffered by the Applicant personally.

III. ASSESSABLE INCOME

38. The first issue to be determined is whether the $803,000 paid to the Applicant under the Release Agreement is assessable income of the Applicant under s 6-5 and 6-10 of the ITAA in the 30 June 2016 income year.

39. The Respondent submits that it is. The Applicant submits that as the payment was a single undissected lump sum, composed of income and capital amounts, that was paid to settle all claims made by the Applicant in the proceeding he commenced against ZAS and ZAL, the whole payment is capital in nature.

40. In order to determine the issue set out above, it is necessary to consider:

    (a) the character of the payment; that is, whether it is income or capital in nature; and

(b) if the payment is characterised as a mixed payment, then does the fact that the payment is a single undissected lump sum mean that whole payment is to be considered as capital in nature.

41. Section 6-5(1) of the ITAA provides that income according to ordinary concepts or "ordinary income" is assessable income.

42. In order to determine whether a receipt is income or capital it is necessary to examine the character of the payment in the hands of the taxpayer.

43. In *Federal Commissioner of Taxation v Dixon* (1952) 86 CLR 540, the Court held:

> *What is paid is not salary or remuneration, and it is not paid in respect of or in relation to any employment of the recipient. But it is intended to be, and is in fact, a substitute for—the equivalent pro tanto of—the salary or wages which would have been earned and paid if the enlistment had not taken place. As such, it must be income, even though it is paid voluntarily and there is not even a moral obligation to continue making the payments.* ***It acquires the character of that for which it is substituted and that to which it is added.***[8]
>
> (Emphasis added)

44. Compensation paid to a taxpayer generally acquires the character of that for which it is substituted. Furthermore, compensation paid under an insurance policy to fill the place of a revenue receipt is income.

45. In *Carapark Holdings Ltd v Federal Commissioner of Taxation* (1967) 115 CLR 653, the Court considered the payment to a widow of insurance in relation to the death of her husband in an air accident while he was travelling in the course of his employment. The Court stated:

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[8] Page 568. See also *Commissioner of Taxes (Vic) v Phillips* (1936) 55 CLR 144, per Dixon and Evatt JJ, at p156, stating "It is true that to treat a sum of money as income because it is computed or measured by reference to loss of future income is an erroneous method of reasoning erroneous because, for example, the right to future income may be an asset of a capital nature and the sum measured by reference to the loss of the future income may be a capital payment made to replace that right. Or, again, the computation may be done for the purpose of ascertaining what capitalized equivalent should be paid for the future income. But, where one right to future periodical payments during a term of years is exchanged for another right to payments of the same periodicity over the same term of years, the fact that the new payments are an estimated equivalent of the old cannot but have weight in considering whether they have the character of income which the old would have possessed". (Citations omitted.)

> *The reasons may be summarized by saying that, in general, insurance moneys are to be considered as received on revenue account where the purpose of the insurance was to fill the place of a revenue receipt which the event insured against has prevented from arising, or of any outgoing which has been incurred on revenue account in consequence of the event insured against, whether as a legal liability or as a gratuitous payment actuated only by considerations of morality or expediency.*[9]

46. Where a settlement or damages are paid in relation to claims under an insurance policy, it is necessary to examine the nature of the claim or cause of action for which the settlement payment was made to determine the character of that payment. In *Sydney Refractive Surgery Centre Pty Ltd v Commissioner of Taxation* [2008] FCA 454; (2008) 70 ATR 874, Ryan, Edmonds and Gordon JJ stated:

> *Whether a payment of compensatory damages is assessable must be determined by looking to the nature of the cause of action in respect of which the payment is made, rather than the way in which damages are calculated.*
>
> *…*
>
> *In the meantime, the proper test was and remains to look at the character of the payment in the hands of the taxpayer: Sydney Refractive Surgery Centre 247 ALR 313 at [45] and the authorities there cited**. For an award of damages, that in turn requires an examination of the nature of the claim or cause of action in respect of which the payment was made**. It is settled that an award of damages for personal injuries is not taxable**: Sydney Refractive Surgery Centre 247 ALR 313 at [65] and authorities there cited.*[10]
>
> (Emphasis added)

47. Accordingly, in order to determine whether the payment of the $803,000 was income or capital in nature, it is necessary to examine the nature of the claim or cause of action in respect of which the payment was made. It is accepted by the parties, for example, that the $297,000 TPD payment was capital in nature and not part of the Applicant's assessable income.

48. In relation to the remaining $803,000, the Respondent submits that, as there were only two claims (one under the income protection policy and another under the TPD policy) that once the $297,000 paid for the TPD policy amount is deducted from the overall $1.1M settlement payment, then it must be that the remaining $803,000 was apportioned to settle the income protection claim. The nature of the income protection claim, being a

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[9] 663. See also *Rosgoe Pty Ltd Commissioner of Taxation* [2015] FCA 1231.

[10] 558 and 560. See also *Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation* (1989) 20 FCR 288.

failure to make payments under an income protection policy, which obtains its character for that which it substitutes i.e. income, makes the $803,000 form part of the Applicant's assessable income.

49. The Applicant accepts that part of the $803,000 was paid to settle the income protection policy claim, but, he submits, that that amount was also paid to settle other claims brought by the Applicant against the insurers. In particular, he points to those claims made in paragraph 12 of the Statement of Claim, which are particularised to include certain personal harm resulting from the insurers' failure to pay.

50. If the $803,000 was paid to settle not only the income protection policy claim, as the Applicant submits, but was also paid for other claims that are not revenue, in this case a claim for damages, and it is not possible to apportion which part of the $803,000 was paid to settle those claims, then the payment amounts to a single undissected lump sum.

51. Where a single undissected lump sum is paid to settle claims of an income and capital nature, then the legal principle applies to make the whole payment capital in nature.

A. A single undissected lump sum

52. The parties made submissions in relation to the legal principles to be applied in this application and in particular in relation to the principle concerning the characterisation for taxation purposes of payments made as a single undissected lump sum.

53. The Applicant relied principally upon *McLaurin v Federal Commissioner of Taxation* (1961) 104 CLR 381 and *Allsop v Federal Commissioner of Taxation* (1965) 113 CLR 341. The Respondent cited *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102.

54. In *McLaurin v Federal Commissioner of Taxation* (1961) 104 CLR 381, Dixon CJ, Fullagar and Kitto JJ considered a payment made by the Commissioner for Railways (NSW) of £12,350 in full settlement of a claim for damages, which was the subject of an action then pending in the Supreme Court of New South Wales. The Court stated as to the facts of the case:

> *The claim was in respect of damage done on a grazing property of the appellant, on 24th January 1952, by a fire which had commenced on land of the defendant*

Commissioner. The appellant's case, as appears from the declaration which he filed in the action, was that the defendant Commissioner was liable to him in damages, either for not having taken reasonable care in relation to the fire or on the principle of Rylands v. Fletcher (1). The amount claimed in the writ was £30,000. Before the issue of the writ the appellant had supplied particulars, under a number of heads, of the damage he had sustained and of the amounts which he intended to claim in respect of each head of damage. The total of these amounts was £30,240. The settlement of the action was reached after negotiations in which the Commissioner for Railways was represented by a Mr. Cameron. He was a valuer employed by the Commissioner for Railways, and had visited the appellant's property as early as November 1952 to make his own assessment of the damage caused by the fire. Discussions without prejudice took place first between Mr. Cameron and a brother and a nephew of the appellant, and ultimately between Mr. Cameron and the appellant himself. At their conclusion Mr. Cameron, having consulted the Assistant Solicitor for Railways, told the appellant that the Commissioner for Railways was prepared to offer a lump sum of £12,350, together with costs, to settle the case. He gave the appellant no information as to how this sum had been arrived at, and the appellant without knowing how it had been arrived at, agreed to accept it.

…

Apparently the respondent had ascertained how the £12,350 had been arrived at by Mr. Cameron, and he reached his own figure of £10,640 by taking Mr Cameron's list of items and accepting the amounts shown therein, subject to some omissions and some adjustments.

It does not accord with fact, for an account of the manner in which Mr. Cameron reached his total is only an account of his reasons for the recommendation he made to the Assistant Solicitor for Railways; and even though those reasons may have been adopted by that officer, or even by the Commissioner for Railways himself, the offer that was made was not of a total of itemized amounts, but was of a single undissected amount. And in point of law it would plainly be unsound to allow a determination of the character of a receipt in the hands of the recipient to be affected by a consideration of the uncommunicated reasoning which led the payer to agree to pay it.[11]

55. The Court then set out the relevant principle:

It is true that in a proper case a single payment or receipt of a mixed nature may be apportioned amongst the several heads to which it relates and an income or non-income nature attributed to portions of it accordingly. But while it may be appropriate to follow such a course where the payment or receipt is in settlement of distinct claims of which some at least are liquidated, or are otherwise ascertainable by calculation, it cannot be appropriate where the payment or receipt is in respect of a claim or claims for unliquidated damages only and is made or accepted under a compromise which treats it as a single, undissected amount of damages. In such a case the amount must be considered as a whole.[12]

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11 389-391.

12 391.

56. In *Allsop v Federal Commissioner of Taxation* (1965) 113 CLR 341, the High Court considered an action to recover sums paid for permit fees wrongly exacted under state legislation. The appellant entered into a deed of release in relation to the cause of action and other claims for acts done pursuant to legislation resulting in payment to him of what was described as an undissected lump sum which was less than the amount he had sued for. The Commissioner sought to include the lump sum in the appellant's assessable income.

57. In joint reasons, Barwick CJ and Taylor J set out the facts:

> *The particulars given show that what the appellant was claiming to recover in this action were the amounts which had been paid by him as and for permit fees between April 1951 and the end of June 1954. The basis of the claim was that these amounts had been "improperly demanded under colour of office".*[13]

58. Their Honours continued:

> *His claim for a refund of the fees paid by him was not admitted by the Commissioner and the amount payable upon the execution of the release was the consideration not only for a release of his claim against the Commissioner in respect of the fees paid by him for permits but also for his release of all claims for anything done in purported pursuance of the State Transport (Co-ordination) Act.*[14]

59. Similarly, Windeyer J, writing separately, stated:

> *He had commenced an action to recover from the Government of New South Wales the sum of £54,868 as money had and received to his use. He took £37,000 not simply in satisfaction of his claim in that action but in consideration of his release by deed of a variety of claims that he had, or might be thought possibly to have, against the Government. It does not appear from the material before us that the sum of £37,000, or any definite part of it, was computed, paid and received as a refund of particular amounts that had been paid by the appellant for road charges and which had been allowed as deductions in the assessment of his taxable income.*[15]

60. In *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102, Merkel J stated:

> *… it is difficult for the applicant to argue that the surrounding circumstances are not relevant to the characterisation of the settlement amount. In my view, the true nature and proper characterisation of the settlement amount is to be determined by having regard to the policy, the applicant's claims under the policy, the terms of*

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13 348.

14 351.

15 352.

settlement which, inter alia, settled those claims and the rights the applicant will be surrendering upon the cancellation of the policy.[16]

61. His Honour considered the nature of the claim:

> *…it is clear from the terms of settlement and the claims settled by those terms that the fundamental element in the payment of the settlement amount was that it settled the past and future income replacement claims of the applicant.*
>
> *It is well established that, in general, insurance monies are received on revenue account where the purpose of the insurance was to fill the place of the revenue receipt which the event insured against has prevented from arising: see Carapark Holdings Ltd v The Commissioner of Taxation (1967) 115 CLR 653 at 663. Thus, amounts payable under a policy that provides a monthly indemnity against income loss arising from inability to earn are of a revenue character: see Commissioner of Taxation v Smith (1981) 147 CLR 578 at 583-584.*
>
> *…*
>
> *The fact that the payment of the monthly benefits in the present case is made in one lump sum does not change the revenue character of the receipt if it was essentially designed to compensate the applicant in respect of his income replacement claims or was a payment in substitution for those claims: see Allied Mills at 310-312 and Henry Jones (IXL) Ltd v Commissioner of Taxation (1991) 31 FCR 64 at 78-79 and 80.*
>
> ***...***
>
> *When monies are received in consideration of surrendering a benefit to which the recipient is entitled under a contract, the inquiry as to whether the receipt is of capital or of income requires consideration of the "congeries of rights" which the recipient enjoyed under the contract and which, for a price, were surrendered: see Van den Berghs Ltd v Clark [1935] AC 431 at 443, Bennett v Federal Commissioner of Taxation (Cth) (1947) 75 CLR 480 at 485 and Allied Mills at 299.*
>
> *…*
>
> *The applicant also sought to rely upon the loss of particular benefits payable under the policy, other than in respect of income replacement, such as minimum benefits for death and particular disabilities and indemnity for rehabilitation and hospitalisation expenses. However, no claims of that kind had been made or threatened by the applicant. Thus, there is an air of unreality and artificiality about the applicant's contention that there was a capital element involved in the cancellation of the policy, and therefore in the settlement amount.*[17]

62. In *Allied Mills Industries Pty Ltd v Federal Commissioner of Taxation* (1989) 20 FCR 288, a Full Court of the Federal Court, considered to *Allsop v Federal Commissioner of Taxation* (1965) 113 CLR 341 and *McLaurin v Federal Commissioner of Taxation* (1961) 104 CLR 381, and held:

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16 [12]

17 [14]-[17].

McLaurin and Allsop were cases of payments of lump sums paid pursuant to releases in settlement of claims for unliquidated damages or claims which included claims for unliquidated damages where the settlement treated the payment as a single undissected amount of damages, one incapable of severance. In neither case was the lump sum capable of apportionment between the causes of action. The receipts by the taxpayers were of moneys derived outside the ordinary trading activities of the businesses and were therefore of a capital nature.

In Spedley this Court approached the matter on the basis that, as the Administrative Appeals Tribunal, from whose decision the appeal was brought to this Court, had found that the receipt was a lump sum which was at least in a substantial part compensation for injury to a capital asset, namely, goodwill, and, as the parties had agreed that this was an item of capital, what was received was not capable of dissection or apportionment.[18]

B. The submissions

63. The authorities considered above make plain that in order to characterise the payment of $803,000 it is necessary to consider the nature of the claim that the payment seeks to settle.

64. In particular, as Merkel J stated in *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102, in the present circumstances, being receipt of a settlement amount paid with respect to an insurance policy, the characterisation of that settlement amount "is to be determined by having regard to the policy, the applicant's claims under the policy, the terms of settlement which, inter alia, settled those claims and the rights the applicant will be surrendering upon the cancellation of the policy."[19]

65. The Respondent submits that the entirety of the $803,000 was paid as compensation for the loss of income replacement benefits under the IP policy, taking into account the rights under the policy, the claims, the settlement of those claims and the rights that the Applicant surrendered.

66. The Respondent submits that the relative percentages of the amounts paid under the settlement correspond to the two claim amounts for the TPD and IP policies. This gives rise to an inference that the $803,000 was paid to settle the income protection claim

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18 313.

19 [12].

alone. The Respondent submits that the Applicant's original claim for $2,779,198 was composed as follows:

(a) $738,729 for the TPD policy claim; and

(b) 360 monthly income replacement benefit payments of $5,667.97, which equals $2,040,469. In arriving at this amount, the Respondent relies upon the email referred to above, dated 7 December 2016.

67. The Respondent submits that having regard to the total amount claimed by the Applicant, which was $2,779,198, the income replacement benefit amount of $2,040,469 amounts to 73 per cent of that total claim amount and that the TPD policy amount of $738,729 amounts to 27 per cent of the total claim amount.

68. The Respondent submits that the settlement sum of $1.1 million was apportioned to correspond with the amounts claimed: $297,000 for the TPD claim which is 27 per cent of the settlement sum; and $803,000 for the IP claim which amounts to 73 per cent. The obvious inference, according to the Respondent, is that the components of the settlement sum were intended to represent the proportions that the monetary claims relating to each insurance policy bore to the total claim amount. The fact that the income protection policy settlement amount was not labelled in the Release Agreement as corresponding to the income protection policy claim, rather being expressed at clause 1 to be for "the balance of the Settlement Sum", the Respondent submits does not change what it was paid for when one looks at all of the relevant circumstances.

69. Further, the Respondent refers to the definition of "Claims" at clause 2 of the Release Agreement, which is defined in Recital I as the "TPD Claim" and the "IP Claim". The Respondent submits that the releases given by the Applicant in exchange for the receipt of the settlement sum relate to only those two claims.

70. The Applicant accepts that part of the $803,000 was paid to settle the income protection policy claim. However, he submits that amount was also paid to settle those claims under paragraph 12 of the Statement of Claim particularised to include harm resulting from the insurers' failure to pay.

71. The Applicant submits that the percentages calculated by the Respondent are irrelevant and cannot substitute an examination of the facts which explain the purpose and application of the settlement payments.

C. Application

72. The email from which the Respondent derives what he submits are corresponding percentages leading to an inference makes plain that the author does not know the basis of the calculations of the payments. The email states "[w]e have previously verbally advised that the settlement was an negotiated amount and has no basis of calculation."

73. The Respondent's submission draws parallels to the concerns raised by the Court in *McLaurin v Federal Commissioner of Taxation* (1961) 104 CLR 381, which stated:

> *And in point of law it would plainly be unsound to allow a determination of the character of a receipt in the hands of the recipient to be affected by a consideration of the uncommunicated reasoning which led the payer to agree to pay it.*[20]

74. Accordingly, an inference such as the one suggested by the Respondent could not be relied upon absent actual evidence of reasoning. I find that the percentages do not support the inference suggested by the Respondent.

75. The relevant evidence in this case is most importantly, as reasoned in *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102, the Release Agreement and the Statement of Claim.

76. The Respondent, in his written submissions, submits that the "substance and commercial reality" of the settlement, citing *Sommer v Federal Commissioner of Taxation* (2002) 51 ATR 102 at 107, is that the amounts that do not relate to claims under the TPD policy must relate to the claims under the IP policy. Other than the Respondent's reference to the definition of "Claim" in the Release Agreement, the Respondent in its submissions does not proceed to consider the payments by reference to the positive evidence. A focus upon the definition of "Claim" in the Release Agreement without a consideration of the other provisions is apt to mislead.

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[20] 390.

77. Clause 2 of the Release Agreement contains the releases which are stated to include all claims against the insurers “in any way related to the Proceeding, the Claims, the Zurich Policies” or “allegations arising out of or in any way related” to those matters.

78. Clause 1, in turn, provides that in consideration of the undertaking and covenants provided, importantly the release itself, payment of $1.1 million is made to discontinue the Proceeding and, “[i]n so far as the Proceeding relates to the TPD Claim” the sum of $297,000, and the balance equalling $803,000. Clause 1 provides in clear terms what the first payment is intended to settle, being the TPD claim, and inasmuch it operates to carve out the TPD claim from the total amount.

79. On the other hand, the second larger payment of $803,000 is not stated, as the Respondent might prefer, to be paid “insofar as the Proceeding relates to the IP Claim.” That the Release Agreement does not attribute the $803,000 to the IP claim is consistent with the other clauses of the Agreement, as the insurers clearly sought to release themselves from all present and future claims, however made. The parties considered that there were claims beyond the TPD and IP claims. That is evident from the wording of the release in clause 2 being for all claims against the insurers “in any way related to the Proceeding, the Claims, the Zurich Policies” or “allegations arising out of or in any way related” to those matters. Accordingly, when examined in context, clause 1 does not attribute the $803,000 exclusively to the release for the income protection claim.

80. An examination of the Statement of Claim further assists to explain the payments under the Release Agreement. The Statement of Claim sets out each of the IP and TPD policies. In relation to the IP policy, at paragraph 11, it is pleaded that in breach of the policy the First Defendant failed to:

    (a) pay the income benefit; and

    (b) waive the premium.

81. The Applicant pleads, at paragraph 12, “in the alternative to paragraph 11”, that the Plaintiff suffered loss and damage, particularised as:

    (a) loss of benefits;

    (b) loss of premium;

(c) compensation for the taxation consequences for being paid a lump sum instead of monthly payments; and

(d) "inconvenience, mental anguish, personal insecurity and distress suffered by the Plaintiff as a result of his loss of money and financial security."

82. The claim at paragraph 11 for breach of contract is pleaded as a claim for loss and damage at paragraph 12. The latter claim is more expansive in that it adds to the contractual claim to include the taxation consequences and, in addition, personal distress suffered as a result of the insurers' conduct in not paying the income benefits.

83. As the claim in paragraph 12 is pleaded in the alternative to paragraph 11, the Applicant's claim appears, at that stage of the pleading to be an "either or" plea as it is stated to be in the alternative. That plea conflicts with the final "and the plaintiff claims" part of the Statement of Claim which is expressed to be further and in the alternative.

84. I find that part of the plea at paragraph 12 of the Statement of Claim is made in alternative because:

(a) the "and the plaintiff claims" part of the Statement of Claim is expressed to be further to paragraph 11;

(b) the first two heads of claim at paragraphs 11 and 12 (in relation to the non-payment of income benefit and the non-waiver of the premium) overlap and are logically made in the alternative. However, the second two heads of claim particularised at paragraph 12 being, loss and damage attributable to inconvenience, mental anguish, personal insecurity and distress suffered by the Plaintiff as a result of his loss of money and financial security, are further to those in paragraph 11; and

(c) the fact that the TPD claim is not similarly itemised supports such a conclusion.

85. I find that the payment of $803,000 in the scheme was made to the Applicant not only for the insurers' breach of the IP policy for monthly payments of income benefit, which in the

hands of the Applicant are income, but also for personal harm particularised at paragraph 12 of the Statement of Claim arising or resulting from the insurers' conduct because:[21]

(a) The express words of clause 1 of the Release Agreement in relation to the $803,000 payment states that the payment is for "the balance" of the total settlement payment after the payment for the TPD claim is carved out.

(b) The release in clause 2 of the Release Agreement is wider than the claims made under the insurance policies.

(c) The Statement of Claim, for the reasons set out above, makes claims for amounts in addition to the claim for payment of income benefits and waiver of premium these include:

(i) compensation for the taxation consequences for being paid a lump sum instead of monthly payments; and

(ii) "inconvenience, mental anguish, personal insecurity and distress suffered by the Plaintiff as a result of his loss of money and financial security."

86. Accordingly, I find that the payment of $803,000 to the Applicant was not apportioned exclusively to compensate the Applicant for the loss of income benefits, but rather was paid to compensate the Applicant for all claims, other than the TPD claim, including a claim for loss and damage caused by the insurers' conduct, which formed part of the release in clause 2 of the Release Agreement, and that, as a result, it constituted a single undissected sum settling all remaining non-TPD claims with the effect that the whole of the payment was capital in nature.

IV. EXEMPTION FROM CAPITAL GAINS TAX

87. The Applicant poses a further question: whether the lump sum amount of $803,000 is exempt from CGT under s 118-37(1)(a) of the ITAA because the sum is a capital gain relating directly to compensation or damages for a wrong, injury or illness suffered by the

[21] An interesting question, which is unnecessary for me to decide, arises as to whether there ought be a presumption that the settlement payment included a component for costs.

Applicant personally. As noted above, I am satisfied that I am able to answer this question.

88. Section 118-37(1) contains various CGT exemptions and provides, in relevant part:

> *A *capital gain or *capital loss you make from a *CGT event relating directly to any of these is disregarded:*
>
> *(a) compensation or damages you receive for:*
>
> *(i) any wrong or injury you suffer in your occupation; or*
>
> *(ii) any wrong, injury or illness you or your *relative suffers personally;*

89. The Applicant submits that s 118-37(1)(a) applies.

A. Application

90. I have found that the $803,000 payment received by the Applicant was consideration for his release of all claims made in the proceeding, excluding the TPD claim, and which included loss and damage for inconvenience, mental anguish, personal insecurity and distress suffered by the Applicant as a result of the non-payment of the income benefits by the insurers and financial security resulting therefrom.

91. The particulars to paragraph 12 of the Statement of Claim include a claim for damages for a wrong or injury suffered personally by the Applicant. Payment of that part of the $803,000 might amount to a capital gain relating directly to compensation or damages for a wrong or injury that the Applicant suffered personally. However, it is not possible to dissect which portion of the $803,000 is attributable to that part of the claim made in paragraph 12 of the Statement of claim.

92. In *Dibb v Commissioner of Taxation* (2004) 136 FCR 388, the Court of Appeal cited and agreed with the decision of the primary judge who stated:

> *even accepting that some of the complaints of damage the applicant raised in the Federal Court proceeding consisted of anxiety and depression and thus "personal injury", the Commissioner was correct in concluding there was no way of dissecting the total settlement sum to include an amount for*

> *such a payment: McLaurin v Federal Commissioner of Taxation (1960-1961) 184 CLR 391.*[22]

93. Further, although the allegation was made in paragraph 12 of the Statement of Claim, there was no evidence before the Tribunal of a wrong or injury suffered personally by the Applicant.

94. The Court in *Dibb v Commissioner of Taxation* (2004) 136 FCR 388 stated:

> *The occasion for apportionment pursuant to s 27A(l)(n) only arises if there can be said to be "consideration of a capital nature for, or in respect of, personal injury to the taxpayer. Here, it is impossible to say whether there was or was not personal injury. AVCO denied it. The section does not provide for "consideration ... of, or in respect of, allegations of personal injury". As can be seen from the description of the allegations in the Federal Court proceedings and the terms of the deed, there was no agreement between the parties that Mr Dibb had suffered personal injury. It was submitted on his behalf (as it had to be) that the respondent was obliged to sit, in effect, as a tribunal to decide whether he suffered personal injury and if so, the amount of a reasonable payment therefore. We disagree. The respondent was correct, as was his Honour, in concluding that it was impossible to identify any part of the total sum of $788,544 as consideration for, or in respect of personal injury.*[23]

95. Therefore, I find that s 118-37(1)(a) of the ITAA did not apply to the lump sum amount of $803,000 to make it exempt from CGT.

V. DECISION

96. The Tribunal sets aside the decision under review and remits it to the Respondent with the finding that the lump sum payment of $803,000 is not assessable to the Applicant in the income year ended 30 June 2016.

> *I certify that the preceding 96 (ninety-six) paragraphs are a true copy of the reasons for the decision herein of Senior Member R. Pintos-Lopez*

……[SGD]……..
Associate

Dated: 7 March 2019

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22 406.

23 406. See also *Purvis v Federal Commissioner of Taxation* (2013) 90 ATR 739 at 756.

Date of hearing:	**26 March 2018**
Counsel for the Applicant:	**Mr Michael Flynn QC & Ms Fiona Cameron**
Solicitors for the Applicant:	**Pitcher Partners Advisors Pty Ltd**
Counsel for the Respondent:	**Ms Mia Clarebrough**
Solicitors for the Respondent:	**Australian Taxation Office**