

Ruling Compendium – TD 2016/D1

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2016/D1 *Income tax: is a redemption payment received by a worker under the Return to Work Act 2014 (SA) assessable income of the worker?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft Determination.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1.	Subsection 39(1) of the <i>Return To Work Act 2014</i> (SA) (RWA) ¹ applies where a worker suffers work injury 'that results in incapacity for work', and entitles such a worker to weekly payments 'in respect of that incapacity'. This indicates that such payments are for an incapacity for work, even though they are made on a weekly basis.	While weekly payments are in respect of 'incapacity for work', they are not concerned with any of the effects of incapacity other than a loss of income; see paragraphs 21-23 of the draft Determination.
2.	The redemption of a liability to make weekly payments by payment of a capital sum recognises the fact that the worker has suffered a loss of earning capacity arising from a compensable work injury.	The redemption payments covered by the draft Determination are made pursuant to subsection 53(1) or 54(3). On the terms of those provisions, a redemption payment is a payment to redeem a liability to make weekly payments; see paragraph 30 of the draft Determination. While weekly payments are in respect of 'incapacity for work', they are not concerned with any of the effects of incapacity other than a loss of income; see the response to Issue No. 1 above.

¹ All legislative references in this Compendium are to the RWA unless otherwise indicated.

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3.	Monies paid to a worker to redeem a liability to make weekly payments are not a replacement, substitution or compensation for weekly payments which would otherwise be made. A redemption payment is determined by agreement and there is no statutory formula. The amount of the payment depends on a variety of considerations and there is often no correlation between the amount of the payment and the actual pecuniary loss of revenue suffered by the worker. In most cases, the entitlement to weekly payments and compensation for the cost of medical services cannot be quantified, given the potential for future changes in circumstances.	By definition, a redemption amount covered by the draft Determination is a payment to redeem a liability to make weekly payments. See the response to Issue No. 2 above. This indicates that the redemption amount is income, even though there may not be a precise correspondence between the amount received and the amounts which would otherwise have been received in the form of weekly payments: see <i>FC of T v. D.P. Smith</i> 81 ATC 4114 at 4116 and paragraph 21 of the draft Determination.
4.	Section 53(2)(d) makes it abundantly clear that there must be a determination of the extent of the worker's incapacity resulting from work injury. This is fundamentally a matter of determining the loss of earning capacity; it is not a matter of computing a mathematical formula set out in the legislation the amount of the weekly payments and paying that amount as a lump sum. Where the role of the statutory authority tasked with fixing the compensation is to determine the compensation payable to a person having regard to the deprivation or impairment of the earning capacity of the person by reason of the injury, the character of the payment is capital as it is for a loss of earning capacity.	Weekly payments are determined under the RWA having regard to the worker's notional and current weekly earnings, indicating that such payments are of an income nature. By definition, a redemption amount covered by the draft Determination is an amount paid to redeem a liability to make weekly payments. See response to Issue No. 2 above. Paragraph 53(2)(d) is considered to reflect the fact that a future liability to make weekly payments is likely to be affected by the extent of the worker's incapacity. See further, paragraph 21 of the draft Determination. Section 56 is considered to confirm that redemption amounts are concerned with a loss of future income rather than future income earning capacity; see paragraphs 23 and 31 of the draft Determination.

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5.	The decision in <i>Inkster</i> supports the conclusion that a redemption payments under the RWA are non-assessable capital sums.	The draft Determination is considered to be consistent with the decision in <i>Inkster</i>. In <i>Inkster</i> the issue was whether weekly payments under the <i>Workers' Compensation and Assistance Act 1981</i> (WA) were ordinary income. The Court did not consider the character of a lump sum received in redemption of the obligation to make such payments. The Court held that the weekly payments in question were ordinary income, even though the weekly payments were not based on any actual loss of income. The factors which led the Court to conclude that the payments in question were income apply equally to weekly payments considered in the draft Determination. In addition, however, weekly payments under the RWA are based on an actual, rather than notional loss of income. This serves to distinguish weekly payments under the RWA from payments which are only of an income nature because of their periodicity or recurrence; see paragraphs 22-23 of the draft Determination.
6.	The decision in <i>Coward</i> ² supports the conclusion that redemption amounts under the RWA are non-assessable capital sums.	The redemption payments covered by the draft Determination are considered to be distinguishable from the payment considered in <i>Coward</i> ; see paragraphs 27 to 28 of the draft Determination.
7.	Redemption payments under the RWA should be contrasted with the redemption payment considered in <i>Brackenreg</i> .	The redemption payments covered by the draft Determination are not considered to be relevantly distinguishable from the payment considered in <i>Brackenreg</i> . Whilst redemption payments under the RWA are fixed by agreement rather than in accordance with a statutory formula, a redemption payment is, by definition, a payment to redeem a liability to make weekly payments. See response to Issue No. 2.

² *Coward v. Federal Commissioner of Taxation* [1999] AATA 132; 99 ATC 2166; (1999) 41 ATR 1138.

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8.	The purpose of a statutory payment, as disclosed in the terms of the statute itself, is a powerful though not conclusive aid to determining the character of the payment: <i>Slaven</i>.³ In this regard: • The RWA's characterization of a redemption payment as 'capital' is not without importance. • The object and effect of the lump sum properly understood is not simply to 'substitute' or 'replace' the weekly payments	The draft Determination confirms the importance of considering the purpose of a statutory payment. In considering this question it is necessary to have to regard to what the statute says the payment is for. In this context, sections 53 and 54 indicate that the sole purpose of a redemption payment is to redeem a liability to make weekly payments; see paragraphs 29 and 30 of the draft Determination.
9.	Payments having their origin in capital may be income where they are made to serve the purpose of providing a regular income supplement, even where the recipient does not rely on such amounts and notwithstanding they are computed by calculations that relate to capital considerations. The commutation of such entitlements may constitute capital in the hands of the recipient.	This principle is not considered to apply to payments which are income, irrespective of their periodicity or recurrence; see paragraphs 22-23 of the draft Determination.
10.	Redemption amounts are often payable in the context of a settlement which resolves a number of outstanding matters, only some of which relate to a liability to make weekly payments. If any part of the amounts redeemed under section 53 or 54 includes an amount that is income and an amount that is capital and they cannot be dissected, the whole lump sum is properly capital.	Whilst a redemption amount may be part of a larger lump sum, sections 53 and 54 contemplate that such an amount will be separately identified or will be capable of separate identification on a reasonable basis; see paragraphs 32-35 of the draft Determination.
11.	In the alternative, each case involving a redemption amount has to be considered on its merits on a case by case basis to determine whether the lump sum in question is an approximation of future weekly payments.	Such an analysis is not considered necessary, since, by definition a redemption amount covered by the draft Determination is an amount which redeems a liability to make weekly payments; see response to Issue No 2 above.
12.	Since the introduction of redemption agreements in South Australia, the ATO has consistently treated such payments as capital in nature and not assessable for either income or capital gains tax purposes.	This change in the ATO's view has been taken into account in determining a proposed date of effect for the position in the draft Determination. See paragraphs 3-4 of the draft Determination.

³ *Federal Commissioner of Taxation v. Slaven* (1984) 1 FCR 11; 84 ATC 4077; (1984) 15 ATR 242.