


CR 2010/8 - Income tax: assessability of lump sum compensation receipts and interest paid under section 45A of the Workers Rehabilitation and Compensation Act 1986 (South Australia)

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Class Ruling

Income tax: assessability of lump sum compensation receipts and interest paid under section 45A of the *Workers Rehabilitation and Compensation Act 1986* (South Australia)

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-25 of the ITAA 1997; and
- paragraph 118-37(1)(b) of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is Australian resident individuals who receive an amount of lump sum compensation, or lump sum compensation and interest in respect of that payment, under section 45A of the *Workers Rehabilitation and Compensation Act 1986* (South Australia) (WRCA) as a dependant of a worker who died (hereinafter referred to as a Claimant).

Qualifications

4. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 8 to 24 of this Ruling.

5. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

7. This Ruling applies from 1 July 2008. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

8. The following description of the scheme is based on information provided by the applicant.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

9. WorkCover Corporation of South Australia (WorkCover) is an employer-funded statutory authority constituted under the *WorkCover Corporation Act 1994 (South Australia)*. Under Section 13 of that Act, the functions of WorkCover include administering the WRCA.

10. In 2008, the South Australian Parliament passed significant legislative amendments to the WRCA. In particular, the *Workers Rehabilitation and Compensation (Scheme Review) Amendment Act 2008* introduced section 45A of the WRCA, effective from 1 July 2008.

11. Under section 45A of the WRCA, if a worker dies as a result of a 'compensable disability', compensation in the form of a lump sum is payable by WorkCover to various dependants or potential dependants of the deceased worker.

12. Under section 30 of the WRCA, a disability will be compensable if it arises from employment. Subsection 30(2) states that a disability will arise from employment if:

- (a) in the case of a disability that is not a secondary disability or a disease – it arises out of or in the course of employment; or
- (b) in the case of a disability that is a secondary disability or a disease—
 - (i) the disability arises out of employment; or
 - (ii) the disability arises in the course of employment and the employment contributed to the disability.

13. Dependants or potential dependants of a deceased worker to whom a lump sum from WorkCover may be payable are defined at subsection 45A(1) of the WRCA:

child means a person who—

- (a) is under the age of 18 years; or
- (b) is a full-time student at an educational institution approved by the Corporation for the purposes of this paragraph and is under the age of 26 years; or
- (c) is, by reason of physical or mental disability, incapable of earning a living;

'dependent child' means a child, including an orphaned child, totally, mainly or partially dependent on the worker's earnings;

'dependent partner' means a spouse or domestic partner totally or mainly dependent on the worker's earnings;

'partially dependent partner' means a spouse or domestic partner who is to any extent dependent on the worker's earnings

14. Subsection 45A(12) of the WRCA also provides that, where WorkCover considers it to be justified in the circumstances, lump sum compensation may be payable to 'any other person who is to any extent dependent on the worker's earnings'.

15. The amount of the lump sum payable under section 45A of the WRCA is capped at the 'prescribed sum' pursuant to section 43 of the WRCA, less any section 43 lump sum paid to the relevant worker prior to his/her death. Payments made under section 43 are for non-economic loss.

16. The lump sum compensation that may be awarded by WorkCover under section 45A of the WRCA is distinct from the weekly payments based on the notional weekly earnings of the deceased worker that may be awarded under section 44 of the WRCA to various dependants to compensate economic loss.

17. Under subsection 45A(15) of the WRCA, the Claimant is also entitled to receive interest at the prescribed rate on the amount of compensation payable under section 45A. This interest is calculated in respect of the period beginning on the date the claim for compensation is lodged with WorkCover and ending on the date of the payment to the Claimant.

18. The Claimant is not entitled under section 45A of the WRCA to any interest in respect of the period beginning on the date of the deceased worker's death and ending on the date the claim for compensation is lodged.

19. In accordance with regulations 15(3) and 17 of the Workers Rehabilitation and Compensation (General) Regulations 1999 (South Australia), the prescribed rate of interest is the average of the 12 months fixed-rate personal home loan rate and the fixed-rate unsecured personal loan rate fixed by the National Australia Bank Limited as at the commencement of the financial year in which the compensation is paid. It is calculated on a daily basis and on the balance of unpaid monies.

20. Subsection 53(1) of the WRCA requires WorkCover to make such investigations and inquiries as it thinks necessary to determine a claim for compensation.

21. The Claimant will generally receive the payment of compensation from WorkCover within 2-3 days of WorkCover determining the claim, during which time post-determination interest is paid. This 2-3 day period is generally unavoidable due to the time it takes for the bank to process and clear the payment.

22. A decision on a claim for compensation is a reviewable decision under section 89A of the WRCA.

23. Under section 90 of the WRCA, a person who is directly affected by and dissatisfied with a decision that is reviewable may lodge a notice of dispute with the Workers Compensation Tribunal. Such a notice must be lodged within one month after the Claimant receives notice of the determination unless the Workers Compensation Tribunal allows an extension of time. The Claimant is not considered to have a legally enforceable debt until the expiry of this one month period. This debt will only crystallise at the expiry of one month notwithstanding that WorkCover may have made the payment earlier as a matter of compassion.

24. Following receipt of a notice of dispute, the decision is reconsidered. Where this reconsideration fails to resolve the matter, the Workers Compensation Tribunal will contact the parties involved in an attempt to resolve the dispute by conciliation. Where the dispute cannot be resolved by conciliation, the notice of dispute will be referred for judicial review.

Ruling

Ordinary income

25. Lump sum compensation received by a Claimant under subsection 45A(4) of the WRCA for the death of a worker is not ordinary income under section 6-5 of the ITAA 1997.

Capital gains tax

26. CGT event C2 (section 104-25 of the ITAA 1997) happens when a Claimant receives compensation under subsection 45A(4) of the WRCA in satisfaction of their rights under that Act.

27. A capital gain or capital loss made from the receipt of the compensation under subsection 45A(4) of the WRCA is disregarded under paragraph 118-37(1)(b) of the ITAA 1997.

Interest

28. The amount of interest that accrues under subsection 45A(15) of the WRCA for the period from the date the claim for compensation is lodged until the date the outcome of the claim is determined retains the character of the lump sum compensation receipt.

29. The amount of interest that accrues under subsection 45A(15) of the WRCA in relation to the period from the date the determination is made until the date of payment is assessable income under section 6-5 of the ITAA 1997.

Commissioner of Taxation

17 March 2010

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

30. A receipt is assessable income if:
- it is income in the ordinary sense of the word (ordinary income); or
 - it is not ordinary income but through the operation of the legislation it is included in assessable income (statutory income).

Ordinary income

31. Ordinary income received by a person is included in their assessable income under section 6-5 of the ITAA 1997.
32. The legislation does not provide specific guidance on the meaning of ordinary income. However, a substantial body of case law exists which identifies likely characteristics. Amounts that are periodical, regular or recurrent and relied upon by the recipient for their regular expenditure are likely to be ordinary income, as are amounts that are the product of any employment of, or services rendered by, the recipient (*Federal Commissioner of Taxation v. Rowe* (1995) 60 FCR 99; 95 ATC 4691; (1995) 31 ATR 392).
33. Further, a lump sum statutory personal injury compensation payment may also be income as noted by Ryan J in *FC of T v. Pitcher* [2005] FCA 1154
- ... a lump sum in substitution for the right to receive future weekly compensation payments ... constituted income according to ordinary concepts as representing the present value of that future income and a substitute therefor ...
34. An amount received under section 45A of the WRCA (excluding the subsection 45A(15) interest component) is a one-off lump sum compensation receipt. It does not possess the usual characteristics of ordinary income. It is not a substitute for ordinary income. Therefore the receipt will not be assessable as ordinary income.

Capital gains tax

35. A person may receive an amount under subsection 45A(4) of the WRCA because they were totally or partially dependent on the worker, or would have been dependent on the worker if the worker had not died. Such a receipt may give rise to a capital gain (statutory income) under CGT event C2 (section 104-25 of the ITAA 1997) which relates to cancellation, surrender or similar endings. However, a capital gain or loss made upon the ending of a CGT asset acquired on or after 20 September 1985 is disregarded under paragraph 118-37(1)(b) of the ITAA 1997, if the CGT event is in relation to compensation or damages received for any wrong, injury or illness suffered by a person or a relative of that person.

36. In this case, the compensation received by the Claimant is for a 'wrong, injury or illness' they have suffered, being the death of a worker on whom they were dependent.

37. Therefore, any capital gain or capital loss arising from the CGT event is disregarded under paragraph 118-37(1)(b) of the ITAA 1997 as it relates wholly to compensating the Claimant for a personal wrong, injury or illness.

Interest

38. Interest income is normally regarded as ordinary income for the purposes of section 6-5 of the ITAA 1997.

39. In *Whitaker v. Federal Commissioner of Taxation* (1998) 153 ALR 334; 98 ATC 4285 (*Whitaker*) the full Federal Court considered the assessability of interest on damages awarded for personal injury.

40. The court decided that pre-judgment interest (that is, interest calculated from the time the cause of action arose until the time of judgment) did not have the character of income but was a receipt of a capital nature. It noted that:

- the primary purpose of pre-judgment interest was to compensate the plaintiff for being deprived of the use of the money. It was not compensation for a foregone investment opportunity and did not replace any actual or notional lost income; and
- the pre-judgment interest was one of the components which made up the global sum constituting the amount of the award for which judgment was entered.

41. However, the court decided that post-judgment interest (that is, interest from the time of judgment to the time the compensation amount was paid) was assessable as ordinary income because it had no connection with the cause of action and was payable solely because of the delay between the entry of judgment and payment.

42. Subsection 45A(4) of the WRCA provides that a lump sum is payable where a worker dies as a result of a compensable disability (arising out of employment). A disability which is compensable under the WRCA is defined in section 3 of the WRCA to include any physical or mental injury. As such, a likeness can be drawn between the circumstances of a plaintiff receiving compensation for personal injuries awarded by the courts and a Claimant receiving statutory compensation under the WRCA as both amounts are in respect of compensating personal injury by an award of compensation, including an interest component.

43. Under subsection 45A(15) of the WRCA, the Claimant is entitled to receive interest at the prescribed rate on the amount of compensation payable under section 45A. This interest is calculated in respect of the period beginning on the date the claim for compensation is lodged with WorkCover and ending on the date of the payment to the Claimant. It can therefore be likened to the interest discussed in *Whitaker*.

44. The similarities that exist are such that the interest accrued during the pre-determination period can be characterised in the same way as interest in relation to court awarded damages for personal injury. That is:

- interest that accrues under subsection 45A(15) of the WRCA in relation to the period from the date the claim for compensation is lodged until the date the outcome of the claim is determined can be likened to pre-judgment interest and is not assessable as ordinary income; and
- interest that accrues from the date the claim has been determined until the date the payment is made can be likened to post-judgment interest and is assessable as ordinary income under section 6-5 of the ITAA 1997.

45. Section 51-57 of the ITAA 1997, which provides a statutory exemption for post-judgment interest, does not apply to exempt the interest that accrues from the date the claim has been determined as the exemption is confined to court judgments only.

Appendix 2 – Detailed contents list

46. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains
- CGT events C1-C3 – end of a CGT asset
- CGT exemptions
- compensation income
- income
- lump sum payments
- workers compensation income

Legislative references:

- ITAA 1997 6-5
- ITAA 1997 51-57
- ITAA 1997 104-25
- ITAA 1997 118-37(1)(b)
- WRCA 1986 (SA)
- WRCA 1986 (SA) 3
- WRCA 1986 (SA) 30
- WRCA 1986 (SA) 30(2)
- WRCA 1986 (SA) 43
- WRCA 1986 (SA) 44
- WRCA 1986 (SA) 45A
- WRCA 1986 (SA) 45A(1)
- WRCA 1986 (SA) 45A(4)
- WRCA 1986 (SA) 45A(12)
- WRCA 1986 (SA) 45A(15)
- WRCA 1986 (SA) 53(1)

- WRCA 1986 (SA) 89A
- WRCA 1986 (SA) 90
- WorkCover Corporation Act 1994 (South Australia) 13
- Workers Rehabilitation and Compensation (General) Regulations 1999 (South Australia) 15(3)
- Workers Rehabilitation and Compensation (General) Regulations 1999 (South Australia) 17
- Workers Rehabilitation and Compensation (Scheme Review) Amendment Act 2008 (South Australia)
- TAA 1953
- Copyright Act 1968

Case references:

- Federal Commissioner of Taxation v. Rowe (1995) 60 FCR 99; 95 ATC 4691; (1995) 31 ATR 392
- Federal Commissioner of Taxation v. Pitcher [2005] FCA 1154
- Whitaker v. Federal Commissioner of Taxation (1998) 153 ALR 334; 98 ATC 4285

ATO references

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ATOLaw topic: Income Tax ~~ Assessable income ~~ compensation and ex gratia payments
Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 – end of a CGT asset
Income Tax ~~ Capital Gains Tax ~~ exemptions other than main residence