

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?

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This document has been finalised by TD 2016/18.

 There are Compendiums for this document: **TD 2016/D1EC** and **TD 2016/18EC** .



Draft Taxation Determination

Income tax: is a redemption payment received by a worker under the *Return to Work Act 2014 (SA)* assessable income of the worker?

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Ruling

1. Yes. A redemption payment covered by this draft Determination is ordinary income of the worker and is therefore assessable under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. For the purposes of this draft Determination, a payment is a **redemption payment** to the extent that:

- it is made pursuant to subsection 53(1) or subsection 54(3) of the *Return to Work Act 2014 (SA)* (RWA)¹
- it is made to redeem a liability to make weekly payments under sections 39, 40 or 41, and
- it is not an employment termination payment for the purposes of subsection 82-130(1) of the ITAA 1997.

Date of effect

3. In a series of private rulings, issued over several years, the Commissioner has accepted that amounts substantially similar to those covered by this draft Determination are not assessable for income tax purposes.

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

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4. Therefore, it is proposed that the final Determination, when issued, will only apply to redemption payments made under agreements entered into on or after the date of issue of this draft Determination.

Commissioner of Taxation

10 August 2016

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.*

Return to Work Act 2014 (SA)

Weekly payments

5. The RWA entitles workers suffering a work injury² resulting in incapacity for work to weekly payments in respect of that incapacity³, as well as supplementary income support payments in respect of incapacity arising from certain surgery.⁴

6. Liability to make such payments falls upon the Return to Work Corporation of South Australia (ReturnToWorkSA) or a self-insurer delegated the power and discretions of ReturnToWorkSA.⁵

7. For the first 52 weeks of incapacity, the RWA entitles injured workers to weekly payments equal to:⁶

- their notional weekly earnings⁷ for periods when they have no current work capacity, and
- the difference between their notional weekly earnings and their current weekly earnings for periods when they have some current work capacity.

8. After this initial 52 weeks, seriously injured workers⁸ are entitled to ongoing weekly payments equal to 80% of the amounts described above.⁹ Other injured workers are entitled to weekly payments for a further 52 weeks, equal to 80% of those amounts.¹⁰

9. After the second period of 52 weeks (104 weeks total), injured workers are entitled to claim weekly payments (for up to 13 weeks) for incapacity for work resulting from approved surgery.¹¹

10. Weekly payments:

- cannot exceed a worker's notional weekly earnings¹²
- may be increased in order to equal the Federal minimum wage¹³, and
- may be discontinued or reduced in the event of certain changes in the worker's incapacity or level of remuneration¹⁴, or in the event of the worker reaching retirement age.¹⁵

² Section 7.

³ Sections 39 and 41.

⁴ Section 40.

⁵ Part 9.

⁶ Paragraphs 39(1)(a) and 41(1)(a) and subsections 39(2) and 41(2).

⁷ A worker's notional weekly earnings comprise the worker's average weekly earnings, being the average weekly amount they earned during the preceding 12 months. For complete definitions of relevant terms, see sections 4 and 5.

⁸ Broadly, a 'seriously injured worker' is defined as a worker whose work injury has resulted in permanent impairment and the degree of impairment (as assessed under the Act) is at least 30%: see subsection 21(2).

⁹ Paragraph 41(1)(b).

¹⁰ Paragraph 39(1)(b).

¹¹ Section 40 and paragraphs 33(21)(b) and 39(1)(b). The period of incapacity due to approved surgery must fall outside the second 52 week period.

¹² See section 49.

¹³ Section 42.

Amount received on redemption of a liability to pay weekly payments

11. A liability to make weekly payments may, by an agreement between the worker and ReturnToWorkSA (or a self-insurer), be redeemed by a 'capital payment' to the worker: sections 53 or 54. Such a payment, as described in paragraph 2 of this draft Determination, is the subject of this draft Determination.

12. Section 53 concerns the redemption of a liability to make weekly payments under Division 4. The redemption payment is fixed by agreement and there is no statutory formula for determining its amount.¹⁶ However, an agreement cannot be made unless the worker has received competent professional advice about the consequences of redemption and competent financial advice about the investment or use of the money to be received.¹⁷ Further, a recognised health practitioner must have certified that the extent of the worker's incapacity arising from work injury can be determined with a reasonable degree of confidence.¹⁸

13. Section 54 concerns redemption of a liability to pay compensation for the cost of certain medical services¹⁹ as well as a liability to make weekly income support payments.²⁰ However, a payment is only a 'redemption payment' for the purposes of this draft Determination to the extent that it redeems a liability to make weekly income support payments. The redemption amount is fixed by agreement and there is no statutory formula for determining its amount.²¹ However, an agreement cannot be made unless the worker has received competent professional advice about the consequences of redemption,²² as well as advice from a recognised health practitioner about the future medical services the worker will or is likely to require.²³

Other features of the RWA

14. Only seriously injured workers are potentially entitled to an award of damages from their employer in respect of their injury.²⁴ However, a seriously injured worker who seeks damages relinquishes their right to enter into an agreement to receive a redemption payment²⁵ and, if successful in seeking damages, generally ceases to be entitled to any compensation under the RWA.²⁶

15. Subject to certain exceptions, workers other than seriously injured workers who suffer a work injury resulting in permanent impairment are entitled to compensation for loss of future earning capacity by way of lump sum.²⁷

¹⁴ Section 48.

¹⁵ Section 44.

¹⁶ Subsections 53(3) and 54(5).

¹⁷ Paragraphs 53(2)(a) and 53(2)(b).

¹⁸ Paragraph 53(2)(d).

¹⁹ Section 33.

²⁰ Section 40.

²¹ Subsection 54(5).

²² Paragraph 54(4)(a).

²³ Paragraph 54(4)(b).

²⁴ Paragraph 72(1)(a).

²⁵ Section 73.

²⁶ Section 75.

²⁷ Section 56.

Ordinary income

16. A redemption payment received by a worker under section 53 is considered to be ordinary income, included in the worker's assessable income under section 6-5 of the ITAA 1997. The same treatment is considered to apply to a payment received by a worker under section 54, to the extent that it represents proceeds from the redemption of a liability to make supplementary income support payments under section 40.

17. The ITAA 1997 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 periodic, 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.²⁸ Further, amounts which compensate for lost income or serve as a substitute for other income are themselves income according to ordinary concepts.²⁹

Character of weekly payments

18. Weekly payments to a worker under sections 39, 40 or 41 are considered to be ordinary income of the worker.

19. The calculation and timing of amounts payable under sections 39, 40 or 41 indicate that the sole purpose of such amounts is to recoup,³⁰ replace, substitute³¹ or compensate³² for lost income of the worker. In particular, such amounts:

- are payable on a weekly (that is recurrent) basis
- are directly referable³³ to the average weekly earnings of the worker before the injury
- are reduced by the worker's designated (that is actual) weekly earnings³⁴
- are adjusted by reference to,³⁵ and cannot exceed,³⁶ the amount the worker would have earned, or would have been entitled to earn,³⁷ if they had not been injured.

²⁸ *Federal Commissioner of Taxation v. Rowe* (1995) 60 FCR 99; 95 ATC 4691; (1995) 31 ATR 392; *Carapark Holdings Ltd v. Federal Commissioner of Taxation* (1967) 115 CLR 653; (1967) 14 ATD 402; *Federal Commissioner of Taxation v. Dixon* (1952) 86 CLR 540; (1952) 10 ATD 82.

²⁹ *Federal Commissioner of Taxation v. Smith* (1981) 147 CLR 578; [1981] HCA 10; 81 ATC 4114; (1981) 11 ATR 538; *Federal Commissioner of Taxation v. The Myer Emporium* (1987) 163 CLR 199; [1987] HCA 18; 87 ATC 4363; (1987) 18 ATR 693.

³⁰ *Tinkler v. FC of T* 79 ATC 4641; (1979) 10 ATR 411 (*Tinkler*) at ATC 4643.

³¹ *Tinkler* at 4648; *Brackenreg v. Federal Commissioner of Taxation* [2003] AATA 824; 2003 ATC 2196; (2003) 53 ATR 1116 (*Brackenreg*) at [13]; *Federal Commissioner of Taxation v. Pitcher* (2005) 146 FCR 344; [2005] FCA 1154; 2005 ATC 4813; (2005) 60 ATR 424 (*Pitcher*) at [56]; *Maher v. Federal Commissioner of Taxation* [2005] AATA 272; 2005 ATC 2083; (2005) 58 ATR 1341 at [22]; *Senior v. Federal Commissioner of Taxation* 2015 ATC 10-392 at [63]-[64].

³² *Coward v. Federal Commissioner of Taxation* [1999] AATA 132; 99 ATC 2166; (1999) 41 ATR 1138 (*Coward*) at ATC 2173-2174; *Case X21 90* ATC 239; (1990) 21 ATR 3157 at [15]-[16].

³³ *Coward* at ATC 2169.

³⁴ Subparagraphs 39(1)(a)(ii), 39(1)(b)(ii), 41(1)(a)(ii) and 41(1)(b)(ii).

³⁵ See section 48.

³⁶ See section 49.

³⁷ See section 42.

20. Subsection 49(1) provides that a worker is not entitled to receive, in respect of two or more injuries, weekly payments in excess of the worker's notional weekly earnings. This further confirms that section 39, 40 and 41 are concerned with replacing actual income lost rather than compensating for a reduction in earning capacity. Thus, while additional injuries may cause a further reduction in earning capacity they would not result in an increase in weekly payments unless they also caused a further loss of income.

21. While weekly payments under sections 39, 40 and 41 are in respect of incapacity, those sections are not concerned with any of the effects of injury save for loss of income.³⁸ This indicates that the weekly payments themselves have the character of income, whether or not they precisely correspond to the payments the worker would have received if they had not been injured.³⁹ Weekly payments are 'in respect of incapacity' in the sense that it is worker's incapacity for work which provides the occasion for the replacement of lost income. This approach is confirmed by cases in which amounts described as compensation in respect of incapacity⁴⁰ or injury⁴¹ was found to have the character of income.

22. These characteristics serve to distinguish weekly payments under sections 39, 40 and 41 from payments which are only income in nature because of their periodicity or recurrence.⁴² The former amounts are income whether or not they are paid weekly.

23. Weekly payments may also be contrasted with payments pursuant to statutory compensation provisions dealing specifically with loss of future earning capacity,⁴³ such as those in section 56. The amount payable under such provisions is based on a sum prescribed by statute which bears no relationship to the employee's current or former earnings. The calculation of weekly payments according to the worker's past and current earnings indicates that they reflect an actual loss of income as opposed to a loss of income earning capacity.⁴⁴

Character of redemption payments

24. Section 53 addresses the redemption of a liability to make payments under section 39 or 41 by a 'capital payment'. Similarly, paragraph 54(1)(b) addresses the redemption of a liability to pay supplementary income support payments under section 40.

25. These redemption payments are also considered to be income according to ordinary concepts,⁴⁵ since they represent a recoupment, replacement or compensation for income that would otherwise be derived in the form of weekly payments.

³⁸ *Tinkler* at ATC 4644.

³⁹ *Federal Commissioner of Taxation v. Darcy Peter Smith* 81 ATC 4114 at 4116.

⁴⁰ *Coward*.

⁴¹ *Pitcher; Brackenreg*.

⁴² By way of contrast, see *Coward* at [72]-[73]; *Federal Commissioner of Taxation v. Inkster* (1989) 24 FCR 53; 89 ATC 5142; (1989) 20 ATR 1516 (*Inkster*) at ATC 5158-5160.

⁴³ See *Tinkler* at ATC 4644.

⁴⁴ In contrast, see *Inkster*.

⁴⁵ As a redemption payment is considered to be ordinary income, it is unnecessary to consider whether it is an amount received by way of insurance or indemnity for the purposes of section 15-30 of the ITAA 1997: see paragraph 15-30(b) of the ITAA 1997.

26. The character of a redemption payment of this kind was considered in *Brackenreg*. There the taxpayer received weekly compensation payments from Comcare, which took into account her normal weekly earnings.⁴⁶ Comcare's liability to make these payments was subsequently redeemed for a lump sum.⁴⁷ The AAT found that the taxpayer's weekly compensation was income, since it was in substitution for and was paid for loss of earnings; and the character of that compensation did not change upon being redeemed by the payment of a lump sum.⁴⁸

27. The payment in *Brackenreg* can be distinguished from the payment considered in *Coward*. There the taxpayer received weekly compensation payments, based on his previous average weekly earnings. Upon turning 65, the amount of these payments was reduced by reference to an aged-based formula and the taxpayer became entitled to redeem his right to receive further payments for a lump sum. Matthews J held that although the weekly payments clearly constituted income of the taxpayer, the lump sum was of a capital nature. Matthews J took the view that the object of the lump sum was not to compensate the taxpayer for lost earnings, since the taxpayer had reached retirement age.

28. The payment in *Coward* can be contrasted with a redemption payment under sections 53 or 54. The RWA only permits weekly payments to a worker who has reached retiring age where the worker remains employed; and upon reaching that age there is no recalculation of the amount of weekly payments. These weekly payments retain their character as a substitution for or replacement of lost earnings. Accordingly, a payment redeeming an entitlement to receive weekly payments also has the character of income.

29. This characterisation is considered to follow, despite the labelling of redemption payments as 'capital'⁴⁹ in the RWA. A State Parliament cannot determine by its own legislation whether a receipt answers the description of income or capital.⁵⁰ The tax treatment of the receipt is determined by an assessment of its character in the hands of the recipient, rather than the label given to it. Even so, the purpose of a statutory payment is an important but not conclusive aid to determining whether it constitutes income.⁵¹ The question is what the payment is objectively for, rather than how the parties label it or whether they intended it to be taxed.⁵²

⁴⁶ Sections 131 and 132A of the *Safety, Rehabilitation and Compensation Act 1988*.

⁴⁷ Section 137 of the *Safety, Rehabilitation and Compensation Act 1988*.

⁴⁸ *Pitcher* at [56] where it was held that a lump sum redemption amount received under section 30 of the *Safety, Rehabilitation and Compensation Act 1988* had the character of ordinary income, despite being assessable as an eligible termination payment.

⁴⁹ Subsections 53(1) and 54(3).

⁵⁰ *Federal Commissioner of Taxation v. Slaven* (1984) 1 FCR 11; 84 ATC 4077; (1984) 15 ATR 242 (*Slaven*) at 4085.

⁵¹ *Slaven* at 4085.

⁵² *Slaven* at 4085. In contrast, in *Re Barnett and Commissioner of Taxation (Cth)* [1999] AATA 950; 99 ATC 2444; (1999) 43 ATR 1221, the AAT held that a redemption payment was of a capital nature on the grounds that it would be contrary to the legislative intent of the payment for it to be subject to income tax. It is considered that the Tribunal erred in characterising the payment by reference to the intended tax treatment of the payment, in preference to an objective analysis of the character of the payment in the hands of the recipient.

30. In this regard, the language in sections 53 and 54 indicates that the sole purpose of a redemption payment as defined in this draft Determination is to redeem a liability to make weekly payments.⁵³ In this context, the word ‘redeem’ means to extinguish by paying out, with the worker’s consent.⁵⁴ It follows, therefore, that the sole purpose of such a payment under sections 53 and 54 is to extinguish or pay out a liability to pay amounts which recoup, replace or compensate for lost income. As the sole purpose of a redemption amount is to redeem a liability to make weekly payments, it cannot simultaneously be a payment for other things, such as to compensate for a loss of future income earning capacity or a loss of the right to sue for damages.

31. As noted in paragraphs 15 and 23 of this draft Determination, section 56 concerns compensation for loss of future income earning capacity. This provision confirms that a redemption payment under sections 53 or 54 is concerned with a loss of income arising from incapacity rather than a loss of earning capacity.

Undissected lump sums

32. A redemption amount is considered to be assessable as ordinary income, whether or not it is paid as part of a larger lump sum.

33. A payment may be characterised as wholly capital where it represents an entire sum paid to compromise a number of claims, only some of which relate to assessable income.⁵⁵ However, the redemption payments covered by this draft Determination are payable pursuant to statutory provisions which contemplate their separate identification.

34. A payment under section 53 does not require dissection for income tax purposes, since it is wholly assessable. Further, the amount of that payment must be determined, since it must be ‘fixed by the agreement’ between the parties; and the worker must have received competent advice about the consequences of the redemption and the investment or use of the redemption sum.

35. A payment under section 54 may relate to a liability to pay compensation for medical expenses as well as a liability to make weekly payments. However, such an amount is payable on the condition that the worker has received appropriate advice on the consequences of the redemption and the future medical services which are likely to be required. It is considered that satisfaction of these requirements will either determine the extent to which a payment redeems a liability to make weekly payments; or will otherwise enable an apportionment of the lump sum on a reasonable basis into its constituent elements.⁵⁶

⁵³ Subsections 53(1) and 54(3).

⁵⁴ *John While & Sons Pty Ltd v. Changleng* (1985) 2 NSWLR 163 at 166-167; see also, *Commonwealth v. Esber* (1991) 29 FCR 324; (1991) 101 ALR 35 at [52].

⁵⁵ *McLaurin v. Federal Commissioner of Taxation* (1961) 104 CLR 381; *Allsop v. Federal Commissioner of Taxation* (1965) 113 CLR 341.

⁵⁶ See Taxation Ruling TR 95/35 at paragraph 190.

Employment termination payments

36. A payment is not covered by this draft Determination if it is an employment termination payment for the purposes of subsection 82-130(1) of the ITAA 1997. A redemption payment will be an employment termination payment where it is:

- received by the worker in consequence of the termination of their employment, and
- received no later than 12 months after that termination (or the worker is covered by a determination by the Commissioner under subsection 82-130(5) or 82-130(7) of the ITAA 1997 that this 12 month limitation does not apply).

37. Although each case turns on its facts,⁵⁷ a redemption payment covered by this draft Determination would not ordinarily be received in consequence of the termination of a worker's employment. In this regard:

- A payment under sections 53 or 54 is not made in consequence of termination of employment merely because the termination occurs at about the same time as the payment.⁵⁸
- Such a payment is not in consequence of the termination of employment merely because it redeems a liability to make weekly payments. There is no necessary connection between a worker's entitlement to weekly payments and the termination of their employment.⁵⁹

⁵⁷ See further, Taxation Ruling TR 2003/13 *Income tax: eligible termination payments (ETP): payments made in consequence of the termination of any employment: meaning of the phrase 'in consequence of'.*

⁵⁸ *Bond v. Federal Commissioner of Taxation* [2015] FCA 245; 2015 ATC 20-499.

⁵⁹ By way of contrast, see *Pitcher* and *Seabright v. Federal Commissioner of Taxation* 99 ATC 2011; (1998) 40 ATR 1160.

Appendix 2 – Your comments

38. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

39. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

40. Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	9 September 2016
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/35; TR 2003/13

Legislative references:

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- ITAA 1997 15-30(b)
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- ITAA 1997 82-130(5)
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- RWA 2014 21(2)
- RWA 2014 33
- RWA 2014 33(21)(b)
- RWA 2014 39
- RWA 2014 39(1)(a)
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- RWA 2014 41
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- RWA 2014 56

- RWA 2014 72(1)(a)
- RWA 2014 73
- RWA 2014 75
- Safety, Rehabilitation and Compensation Act 1988 30
- Safety, Rehabilitation and Compensation Act 1988 131
- Safety, Rehabilitation and Compensation Act 1988 132A
- Safety, Rehabilitation and Compensation Act 1988 137

Cases relied on:

- Bond v. Federal Commissioner of Taxation [2015] FCA 245; 2015 ATC 20-499
- Brackenreg v. Federal Commissioner of Taxation [2003] AATA 824; 2003 ATC 2196; (2003) 53 ATR 1116
- Carapark Holdings Ltd v. Federal Commissioner of Taxation (1967) 115 CLR 653; (1967) 14 ATD 402
- Case X21 90 ATC 239; (1990) 21 ATR 3157
- Commonwealth v. Esber (1992) 29 FCR 324; (1991) 101 ALR 35
- Federal Commissioner of Taxation v. Darcy Peter Smith 81 ATC 4114
- Federal Commissioner of Taxation v. Dixon (1952) 86 CLR 540; (1952) 10 ATD 82
- John While & Sons Pty Ltd v. Changleng (1985) 2 NSWLR 163
- Maher v. Federal Commissioner of Taxation [2005] AATA 272; 2005 ATC 2083; (2005) 58 ATR 1341
- Federal Commissioner of Taxation v. Rowe (1995) 60 FCR 99; 95 ATC 4691; (1995) 31 ATR 392
- Senior v. Federal Commissioner of Taxation 2015 ATC 10-392
- Federal Commissioner of Taxation v. Slaven (1984) 1 FCR 11; 84 ATC 4077; (1984) 15 ATR 242
- Federal Commissioner of Taxation v. Smith (1981) 147 CLR 578; [1981] HCA 10; 81 ATC 4114; (1981) 11 ATR 538
- Federal Commissioner of Taxation v. The Myer Emporium Ltd (1987) 163 CLR 199; [1987] HCA 18; 87 ATC 4363; (1987) 18 ATR 693
- Tinkler v. Federal Commissioner of Taxation 79 ATC 4641; (1979) 10 ATR 411

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Cases distinguished:

- Allsop v. Federal Commissioner of Taxation (1965) 113 CLR 341
- Barnett and Commissioner of Taxation (Cth) [1999] AATA 950; 99 ATC 2444; (1999) 43 ATR 1221
- Coward v. Federal Commissioner of Taxation [1999] AATA 132; 99 ATC 2166; (1999) 41 ATR 1138
- Federal Commissioner of Taxation v. Inkster (1989) 24 FCR 53; 89 ATC 5142; (1989) 20 ATR 1516
- Federal Commissioner of Taxation v. Pitcher (2005) 146 FCR 344; [2005] FCA 1154; 2005 ATC 4813; (2005) 60 ATR 424
- McLaurin v. Federal Commissioner of Taxation (1961) 104 CLR 381; (1961) 12 ATD 273
- Seabright v. Federal Commissioner of Taxation 99 ATC 2011; (1998) 40 ATR 1160

ATO references

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