


IT 2424 - Income tax : compensation payments in respect of unlawful acts of discrimination

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TAXATION RULING NO. IT 2424

INCOME TAX : COMPENSATION PAYMENTS IN RESPECT OF
UNLAWFUL ACTS OF DISCRIMINATION

F.O.I. EMBARGO: May be released

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REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1206396 COMPENSATION PAYMENTS
ELIGIBLE TERMINATION 27A(1)
PAYMENTS
SEX DISCRIMINATION ACT

OTHER RULINGS ON TOPIC:

FACTS

The Sex Discrimination Act (Commonwealth) 1984 (the Act) makes it unlawful to discriminate on the ground of sex, marital status or pregnancy in specific areas including work and employment. The scope of the Act is broad, although its operation is restricted in relation to certain employers, e.g. State Instrumentalities, and to certain jobs or fields of work, e.g. where issues of decency arise or where religious practices are involved. The Act does not operate where an act of discrimination is done in direct compliance with certain other Acts and laws.

2. In the area of employment the Act prohibits a wide range of discriminatory actions and conduct. The Act makes unlawful any discrimination in determining who should be offered employment. It prohibits an employer discriminating in the terms or conditions of employment afforded employees or in the provision of benefits associated with employment. It prohibits the sexual harassment of an employee and makes it unlawful to subject an employee to detriment or to dismiss an employee on the ground of his or her sex, marital status or pregnancy.

3. An employee (including a prospective or former employee) who considers that he or she has been subjected to an unlawful act of discrimination may lodge a complaint with the Human Rights and Equal Opportunity Commission. Initially, the Sex Discrimination Commissioner enquires into the matter and endeavours by conciliation to effect a settlement between the parties involved in the dispute. If the matter is not settled in this way the Human Rights and Equal Opportunity Commission intervenes, investigates the complaint and determines whether, in terms of the Sex Discrimination Act, an unlawful act of discrimination has occurred.

4. Where a settlement is reached between the parties

involved in the dispute or where the Commission finds a complaint of discrimination to be substantiated it is usual for the employer to take action to redress the loss or damage suffered by the employee as a result of the discriminatory conduct. The employer may agree to or be ordered to engage or reinstate the employee, to eliminate discriminatory terms or conditions of employment, to cease engaging in discriminatory or harassing behaviour or to pay compensation for any loss or damage suffered by the employee.

5. It is common in cases of sex discrimination for a payment to be made for loss or damage suffered by the employee by reason of the discriminatory conduct of the employer. Payments are intended only to be compensatory in nature - if no loss or damage results from the discriminatory behaviour then no payment is warranted. Compensation may be paid in respect of pecuniary losses, e.g. loss of earnings or extra expenses incurred, and non-pecuniary losses or damage, e.g. loss of self-esteem, injury to feelings, public humiliation, embarrassment, depression, anxiety or distress.

6. Aside from the Commonwealth Sex Discrimination Act a number of States currently have in force legislation covering the area of equal opportunity and sex discrimination. In New South Wales, for example, there is the Anti-Discrimination Act, 1977 and in Victoria there is the Equal Opportunity Act, 1984. Under State legislation discriminatory conduct may also give rise to compensation payments to redress loss or damage suffered by an employee. Although this ruling is concerned with the Commonwealth Sex Discrimination Act it applies equally to compensation payments of the same nature settled or awarded under State legislation.

RULING

7. To illustrate the operation of the income tax law in relation to the receipt of compensation payments under the Act some common examples of sex discrimination and payments of compensation have been selected. The examples serve as a guide only. Ultimately, whether or not a particular payment of compensation is assessable will depend on the facts of the given case.

8. By way of general comment the determination of the character of a compensation payment, and in particular whether it is liable to tax in the hands of an employee, depends upon the nature of the payment. A compensation payment to make up for lost earnings or in substitution for income which would otherwise have been earned is in the nature of income and is liable to income tax in the hands of the employee. On the other hand a payment to compensate for personal injury, injury to feelings, humiliation, embarrassment, depression, anxiety, etc. is not liable to income tax. It is a payment of a capital nature. Nor is the payment liable to tax under the capital gains tax provisions by reason of the exemption provided in sub-section 160ZB(1) for compensation or damages paid for wrong or injury suffered by a taxpayer to his or her person or in his or her profession or vocation.

9. A second issue which is relevant to determining the assessability of a compensation payment is whether a payment in respect of an unlawful dismissal of an employee constitutes an eligible termination payment and subject to special taxation treatment.

Examples of Discrimination

(a) Hiring Practices

10. An employer who fails to offer employment to an applicant for a job, or who delays in hiring an applicant, on the grounds of sex, marital status or pregnancy discriminates unlawfully in terms of the Sex Discrimination Act. The applicant may lodge a complaint with the Human Rights and Equal Opportunity Commission and seek appropriate redress and compensation from the employer. It would be usual for the applicant to request that he or she be engaged, that seniority be back dated, that the employer make up lost wages during the intervening period and that compensation be paid for injury to feelings, loss of self-esteem, humiliation, depression during the period of unemployment, etc.

11. A compensation payment paid to an employee to make up for earnings lost due to failure to hire or a delay in hiring is considered to be income according to ordinary concepts. The whole of the payment is included in the employee's assessable income in the year it is received. A payment to compensate for damages such as injury to feelings, loss of self-esteem, humiliation, depression, etc. is a payment of a capital nature and not liable to tax.

12. It may occur that an employer will simply pay one sum of money to compensate an applicant for the loss of earnings and other claims without any precise regard to loss of earnings, etc. A payment of this nature would be of a capital nature no part of which would be liable to tax. It is not possible to allocate any part of it to loss of income.

(b) Sexual Harassment

13. Sexual harassment occurs where one person makes an unwelcome sexual advance or an unwelcome request for sexual favours to a second person or engages in other unwelcome conduct of a sexual nature in relation to the second person, and that second person reasonably believes that by refusing the advance or request or by taking objection to the conduct he or she would be disadvantaged in some way in connection with work or employment. The Sex Discrimination Act prohibits the sexual harassment of an employee (or prospective employee) by either the employer or a fellow employee.

14. In cases of sexual harassment compensation may be paid for injury such as psychological and emotional injury, injury to feelings, humiliation and embarrassment, loss of self-esteem, anxiety or distress, loss of enjoyment of life, etc. A payment to compensate an employee for injury of this kind is not liable

to income tax.

(c) Terms and Conditions of Employment

15. It is unlawful for an employer to discriminate on the ground of sex, marital status or pregnancy in the terms or conditions of employment afforded employees or in the provision of benefits associated with employment.

16. There are numerous ways in which an employer may discriminate in the terms, conditions or benefits of employment which are granted to employees. More common examples occur in the variation in the salaries, bonuses, allowances, etc. paid to male and female employees performing the same duties; a variation in tenure or security of employment or in the flexibility of working hours; discrimination in providing opportunities for training, transfer, rotation, etc.

17. Any settlement between the parties or a determination of the Commission resulting from the discriminatory conduct would usually require the removal of the discriminatory terms, conditions or benefits of employment. Compensation may be agreed upon or awarded for the loss or damage suffered by the employee in the intervening period.

18. Compensation paid to make up for salaries, bonuses, allowances, etc. that would have been received but for the discriminatory conduct of the employer is considered to be in the nature of income and liable to income tax in the year of receipt. A payment to compensate the employee for damage suffered as a result of poorer working conditions, for example, anxiety suffered because of the lack of employment security or injury to feelings due to denial of flexible working hours, is not considered to be income and is not liable for income tax. Where there has been a denial of opportunities for training, transfer, rotation, etc. and this has resulted in the employee being passed over for promotion, compensation may be paid to make up for the additional income that might otherwise have been earned. A payment of this nature is considered to be income and is liable for tax. On the other hand a payment to compensate for frustration, depression, loss of enjoyment of work, etc. due to denial of transfer or rotation is of a capital nature and is excluded from assessable income.

19. Where, as in paragraph 12 above, an employer makes one payment to compensate an employee for a number of discriminatory matters in the terms and conditions of employment and there is not any specific amount identifiable as income the whole of the payment is accepted as a capital receipt in the hands of the employee and not liable to income tax.

(d) Opportunities for Promotion

20. The Sex Discrimination Act makes it unlawful for an employer to discriminate against an employee on the grounds of sex, marital status or pregnancy "by denying the employee access, or limiting the employee's access to opportunities for

promotion ...".

21. A payment to compensate for loss of higher salary and wages due to the discriminatory conduct is considered to be income and liable to tax in the year it is received. Payments to compensate for impairment to prospects for future promotion or future earning capacity and payments in respect of injury to feelings, humiliation, depression, etc. are capital in nature and are not liable to income tax.

22. As appears in paragraphs 12 and 19 a payment made to compensate for the total loss or damage suffered by the employee without any dissection or allocation of the payment is not liable to tax.

(e) Dismissal

23. It is unlawful for an employer to dismiss an employee on the ground of the employee's sex, marital status or pregnancy.

24. A compensation payment received by way of settlement or under a determination of the Commission in respect of an unlawful act of dismissal qualifies as an eligible termination payment. Essentially, the compensation payment for unlawful dismissal, like a payment for wrongful dismissal settled or awarded under a common law action, is considered to be made "in consequence of the termination of any employment of the taxpayer". The payment falls within the definition of an eligible termination payment and is liable for income tax in accordance with the special eligible termination payment rules.

COMMISSIONER OF TAXATION
2 July 1987