IT 2623 - Income Tax: repayments of sickness benefits

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TAXATION RULING NO. IT 2623

INCOME TAX: REPAYMENTS OF SICKNESS BENEFITS.

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I 1012480	SICKNESS BENEFITS - REPAYMENTS ALLOWABLE DEDUCTIONS	25(1) 51(1)

OTHER RULINGS ON THIS TOPIC: IT 2107

PREAMBLE This Ruling considers a decision of the Administrative Appeals Tribunal which allowed a taxpayer a deduction under subsection 51(1) of the Income Tax Assessment Act 1936 ('the Act') for an amount of sickness benefits repaid to the Commonwealth Department of Social Security. The decision is reported as Case V16 88 ATC 185; AAT Case 4077 19 ATR 3165.

FACTS 2. The taxpayer suffered injury in 1981 while employed as a storeman. While awaiting the outcome of his application for compensation, the taxpayer received weekly amounts of workers' compensation. When these payments ceased, he applied for and was granted sickness benefits under the then Social Services Act 1947 from the Department of Social Security. During the year ended 30 June 1981, he received sickness benefits of $1,528.90. A further amount of $2,632.00 was received from this source in the period July to November 1981. In November 1981, the taxpayer was awarded by the Workers' Compensation Commission of New South Wales a lump sum payment of $40,000 in respect of his incapacity under section 16 of the Workers' Compensation Act 1926 (NSW).

3. Under the Social Security Act 1947 (formerly the Social Services Act), sickness benefits may have to be repaid to the Director of Social Security if compensation payment is awarded following payments of sickness benefits. The taxpayer was required to and did repay to the Department of Social Security in March 1982 an amount of $4,160.90, being the total sickness benefits received in 1981 ($1,528.90) and 1982 ($2,632.00).

4. At the Tribunal hearing, the taxpayer submitted that because the sickness benefits of $2,632.00 he received from July to November 1981 had been fully reimbursed to the Department in March 1982, the amount should not be treated as assessable income in the year ended 30 June 1982 (the repayment of the benefits received in the 1981 year was not an issue before the Tribunal).

5. The Tribunal (Mr P.M. Roach, Senior Member) rejected the taxpayer's argument, but decided that the repayment of $2,632.00 was an allowable deduction under subsection 51(1) of the Act.

6. In arriving at its decision, the Tribunal placed considerable reliance on section 153 of the Social Security Act. This section requires sickness benefits to be repaid if a workers' compensation claim is successful. The Tribunal took the view that the repayment arose out of and in the course of derivation of the income. Accordingly, the Tribunal held that the repayment met the requirements of subsection 51(1) of the Act and was deductible.

RULING

7. Sickness benefits received as compensation for loss of earnings have the characteristics of income. They are fully assessable in the year of receipt under subsection 25(1) of the Act. Similarly, workers' compensation received on a regular basis to replace earnings lost during a period of disability has the characteristics of income and is assessable income.

8. Situations such as that in Case V16, AAT Case 4077, will arise, however, where an amount equivalent to the amount of sickness benefits received is repaid to the Department of Social Security following the award of workers' compensation.

9. The question whether a repayment of sickness benefits gives rise to an allowable deduction depends largely on whether the requirements in the first limb of subsection 51(1) of the Act are met, that is, whether the repayment constitutes a loss or outgoing which is "incurred in gaining or producing the assessable income" of the person who makes the repayment.

10. Under Part XVII of the Social Security Act, the Secretary to the Department of Social Security may require a person to repay the whole or some part of the sickness benefits that the person received when compensation for disability is awarded following payment of sickness benefits. The Secretary of the Department of Social Security has advised that, under section 153 of the Social Security Act (section 115 of the former Social Services Act), liability for repayment of benefits arises only when the Secretary makes a determination of the amount of benefits that is required to be repaid and sets out the determination in a notice in writing to the person liable to make the repayment. No liability for repayment arises purely from the act of receiving sickness benefits or from the award of compensation for disability. Contrary to the findings of the Tribunal, it is not, therefore, a condition of payment of sickness benefits (expressed or implied) that the benefits are to be repaid if compensation for disability is subsequently awarded.

11. Repayment of sickness benefits is made to satisfy the determination made by the Secretary, Department of Social Security, rather than in satisfaction of any repayment condition attaching to the original payment of the sickness benefits.

12. No appeal was lodged against the particular Tribunal decision. However, the decision is not to be followed in other

cases because the required nexus does not exist between the receipt of assessable income (either the sickness benefits received from the Department of Social Security or any assessable portion of a lump sum compensation subsequently received) and the repayment of the benefits by a taxpayer. The repayment of the benefits is not incurred in gaining or producing assessable income. The taxpayer in such a case is therefore not entitled to an income tax deduction under subsection 51(1) of the Act.

13. This view is consistent with two recent decisions of the Administrative Appeals Tribunal which dealt with the deductibility under subsection 51(1) of the Act of the repayment of worker's compensation received after judgment for damages had been entered into. The decisions are reported as Case W78 89 ATC 701; AAT Case 5259 (1989) 20 ATR 3844 and Case W86 89 ATC 744; AAT Case 5347 (1989) 20 ATR 3983. In both decisions the Tribunal found that the repayment of worker's compensation was not deductible under subsection 51(1) of the Act and did not follow the decision in Case V16, AAT Case 4077.

14. The question arises, however, whether original assessments in which the periodic sickness benefits have been included in assessable income may be amended when the benefits are repaid to exclude the benefits from assessable income.

15. This Office has for many years recognised the need to adopt an administrative approach which would ameliorate the strict application of tax law and avoid unfair or illogical treatment of a taxpayer where, for example, overpaid salary or, in this instance, overpaid sickness benefits are required to be repaid subsequent to the income year in which the salary or benefits were received and assessed to tax. The general approach in these circumstances has been to use the amendment provisions in the law, subject to the statutory time limits in those provisions, to exclude the overpayment from the assessable income of the year in which the overpayment was made.

16. The suggestion has been made that this corrective action should be confined to cases where the overpayment was not occasioned by any act or inaction of the taxpayer. The decisive consideration in those cases, however, is whether the taxpayer has repaid the amount of the overpayment.

17. Where the overpayment has been paid back the taxpayer's assessments, subject to one qualification, may be amended to exclude from income tax the amount repaid. The one qualification is that amended assessments can only be made under subsection 170(4) of the Act where an application for amendment is made by a taxpayer within 4 years from the date upon which the tax became due and payable under the original assessment.

COMMISSIONER OF TAXATION
13 December 1990