

TD 2016/18 - 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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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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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.

Ruling

1. Yes. A redemption payment covered by this Determination is ordinary income of the worker and is therefore assessable under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) in the income year in which it is received.
2. For the purposes of this Determination, a payment is a **redemption payment** to the extent that:
 - it is made pursuant to subsection 53(1) of the *Return to Work Act 2014 (SA)* (RWA)¹
 - it is made to redeem a liability to make weekly payments under section 39 or 41, and
 - it is not an employment termination payment for the purposes of subsection 82-130(1) of the ITAA 1997.

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

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Date of effect

3. In a series of private rulings, issued over several years, the Commissioner has accepted that amounts substantially similar² to those covered by this Determination are not assessable for income tax purposes.

4. Therefore, this Determination only applies to redemption payments made under agreements entered into on or after 10 August 2016 (the date of issue of draft Taxation Determination TD 2016/D1).

Commissioner of Taxation

23 November 2016

² See section 42 of the *Workers Rehabilitation and Compensation Act 1986* (SA) (repealed). This Determination does not apply to amounts payable under this provision.

Appendix 1 – Explanation

① *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 injury³ resulting in incapacity for work to weekly payments in respect of that incapacity.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. Weekly payments:

- cannot exceed a worker's notional weekly earnings¹¹
- may be increased in order to equal the Federal minimum wage¹², and
- may be discontinued or reduced in the event of certain changes in the worker's incapacity or level of remuneration¹³, or in the event of the worker reaching retirement age.¹⁴

³ Section 7.

⁴ Sections 39 and 41.

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 See section 49.

¹² Section 42.

¹³ Section 48.

¹⁴ Section 44.

Amount received on redemption of a liability to pay weekly payments

10. 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: section 53. Such a payment, as described in paragraph 2 of this Determination, is the subject of this Determination.

11. 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.¹⁵ 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.¹⁶ 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.¹⁷

Other features of the RWA

12. Only seriously injured workers are potentially entitled to an award of damages from their employer in respect of their injury.¹⁸ However, a seriously injured worker who seeks damages relinquishes their right to enter into an agreement to receive a redemption payment¹⁹ and, if successful in seeking damages, generally ceases to be entitled to any compensation under the RWA.²⁰

13. 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.²¹

Ordinary income

14. 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 in the income year in which it is received.

¹⁵ Subsection 53(3).

¹⁶ Paragraphs 53(2)(a) and 53(2)(b).

¹⁷ Paragraph 53(2)(d).

¹⁸ Paragraph 72(1)(a).

¹⁹ Section 73.

²⁰ Section 75.

²¹ Section 56.

15. 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.²² Further, amounts which compensate for lost income or serve as a substitute for other income are themselves income according to ordinary concepts.²³

Character of weekly payments

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

17. The calculation and timing of amounts payable under sections 39 or 41 indicate that the sole purpose of such amounts is to recoup²⁴, replace, substitute²⁵ or compensate²⁶ for lost income of the worker. In particular, such amounts:

- are payable on a weekly (that is recurrent) basis
- are directly referable²⁷ to the average weekly earnings of the worker before the injury
- are reduced by the worker's designated (that is actual) weekly earnings²⁸
- may be reduced in circumstances where the worker would have ceased working overtime, or worked a diminished amount of overtime, if they had continued to work²⁹, and
- cannot exceed the worker's notional weekly earnings (being their average weekly earnings, subject to certain adjustments).³⁰

18. 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 sections 39 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.

²² *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.

²³ *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.

²⁴ *Tinkler v. FC of T* 79 ATC 4641; (1979) 10 ATR 411 (*Tinkler*) at ATC 4643.

²⁵ *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].

²⁶ *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].

²⁷ *Coward* at ATC 2169.

²⁸ Subparagraphs 39(1)(a)(ii), 39(1)(b)(ii), 41(1)(a)(ii) and 41(1)(b)(ii).

²⁹ See paragraph 48(1)(d).

³⁰ See section 49 and subsection 4(1), definitions of 'notional weekly earnings' and 'average weekly earnings'.

19. While weekly payments under sections 39 and 41 are in respect of incapacity, those sections are not concerned with any of the effects of injury save for loss of income.³¹ 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.³² 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 incapacity³³ or injury³⁴ was found to have the character of income.

20. These characteristics serve to distinguish weekly payments under sections 39 and 41 from payments which are only income in nature because of their periodicity or recurrence.³⁵ The former amounts are income whether or not they are paid weekly.

21. Weekly payments may also be distinguished from payments pursuant to statutory compensation provisions dealing specifically with loss of future earning capacity³⁶, such as those in section 56. Such amounts do not have the character of ordinary income. They are based on a sum prescribed by statute which bears no relationship to the employee's current or former earnings. In contrast, 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.³⁷

Character of redemption payments

22. Section 53 addresses the redemption of a liability to make payments under section 39 or 41 by a 'capital payment'.

23. These redemption payments are also considered to be income according to ordinary concepts³⁸, since they represent a recoupment, replacement or compensation for income that would otherwise be derived in the form of weekly payments.

24. 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.³⁹ Comcare's liability to make these payments was subsequently redeemed for a lump sum.⁴⁰ 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.⁴¹

³¹ *Tinkler* at ATC 4644.

³² *Federal Commissioner of Taxation v. Darcy Peter Smith* 81 ATC 4114 at 4116.

³³ *Coward*.

³⁴ *Pitcher; Brackenreg*.

³⁵ 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.

³⁶ See *Tinkler* at ATC 4644.

³⁷ In contrast, see *Inkster*.

³⁸ 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.

³⁹ Sections 131 and 132A of the *Safety, Rehabilitation and Compensation Act 1988*.

⁴⁰ Section 137 of the *Safety, Rehabilitation and Compensation Act 1988*.

⁴¹ *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.

25. 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.

26. The payment in *Coward* can be contrasted with a redemption payment under section 53. 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.

27. This characterisation is considered to follow, despite the labelling of redemption payments as 'capital'⁴² in the RWA. A State Parliament cannot determine by its own legislation whether a receipt answers the description of income or capital.⁴³ 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.⁴⁴ The question is what the payment is objectively for, rather than how the parties label it or whether they intended it to be taxed.⁴⁵

28. In this regard, the language in section 53 indicates that the sole purpose of a redemption payment as defined in this Determination is to redeem a liability to make weekly payments.⁴⁶ In this context, the word 'redeem' means to extinguish by paying out, with the worker's consent.⁴⁷ It follows, therefore, that the sole purpose of such a payment under section 53 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.

29. As noted in paragraphs 13 and 21 of this Determination, section 56 concerns compensation for loss of future income earning capacity. This provision confirms that a redemption payment under section 53 is concerned with a loss of income arising from incapacity rather than a loss of earning capacity.

⁴² Subsection 53(1).

⁴³ *Federal Commissioner of Taxation v. Slaven* (1984) 1 FCR 11; 84 ATC 4077; (1984) 15 ATR 242 (*Slaven*) at 4085.

⁴⁴ *Slaven* at 4085.

⁴⁵ *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.

⁴⁶ Subsection 53(1).

⁴⁷ *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].

Undissected lump sums

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

31. 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.⁴⁸

32. However, a payment under section 53 does not require dissection for income tax purposes, since it is wholly of an income nature. Such an amount is payable pursuant to statutory provisions which contemplate its separate identification. The amount of the 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.

Employment termination payments

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

- 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).

34. Although each case turns on its facts⁴⁹, a payment under subsection 53(1) would not ordinarily be received in consequence of the termination of a worker's employment. In this regard:

- Such a payment is not made in consequence of termination of employment merely because the termination occurs at about the same time as the payment.⁵⁰
- Such a payment is not made 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.⁵¹

⁴⁸ In contrast see *McLaurin v. Federal Commissioner of Taxation* (1961) 104 CLR 381; *Allsop v. Federal Commissioner of Taxation* (1965) 113 CLR 341.

⁴⁹ 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'*.

⁵⁰ See *Bond v. Federal Commissioner of Taxation* [2015] FCA 245; 2015 ATC 20-499 at [33]-[39].

⁵¹ By way of contrast, see *Pitcher and Seabright v. Federal Commissioner of Taxation* 99 ATC 2011; (1998) 40 ATR 1160.

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- Commonwealth v. Esber (1992) 29 FCR 324; (1991) 101 ALR 35
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- 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; (1965) 14 ATD 62
- 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
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