

## ASSESSABILITY OF PAYMENTS UNDER THE EMPLOYMENT RELATIONS ACT FOR HUMILIATION, LOSS OF DIGNITY, AND INJURY TO FEELINGS

### PUBLIC RULING - BR Pub 01/04

---

**Note** (not part of ruling): This ruling replaces Public Rulings BR Pub 97/3 and 97/3A published in TIB Volume 9, No 3 (March 1997). This new ruling is essentially the same as the previous rulings. The main changes take into account the new employment legislation, update relevant case references, and it clarifies the Commissioner's approach to out of court settlements where he has some doubt about the amount attributed to humiliation, loss of dignity, or injury to feelings. The ruling applies from 1 October 2000 to 30 September 2005.

---

This is a public ruling made under section 91D of the Tax Administration Act 1994.

### Taxation Laws

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies in respect of sections CD 5, CH 3, NC 2, and the definition of "monetary remuneration" in section OB 1 of the Income Tax Act 1994.

### The Arrangement to which this Ruling applies

The Arrangement is:

- The making of a payment to an employee or former employee for humiliation, loss of dignity, or injury to feelings under section 123(c)(i) of the Employment Relations Act 2000; or
- The making of a payment to an employee or former employee pursuant to an out of court settlement genuinely based on the employee's rights to compensation under section 123(c)(i) of the Employment Relations Act 2000.

This Ruling does not, however, apply to such payments that are in reality for lost wages or other income, but which are merely characterised by the parties as being for humiliation, loss of dignity, or injury to feelings (irrespective of whether such an agreement is signed by a mediator under the Employment Relations Act).

### How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Payments that are genuinely and entirely for compensation for humiliation, loss of dignity, or injury to feelings under section 123(c)(i) of the Employment Relations Act 2000 are not "monetary remuneration" in terms of the definition in section OB 1 of the Income Tax Act 1994. Consequently, such payments do not form part of the gross income of the employee under section CH 3.

- Such compensation payments are not gross income under ordinary concepts under section CD 5.
- There is consequently no liability under section NC 2 for employers or former employers to deduct PAYE from these payments.

**The period for which this Ruling applies**

This Ruling will apply to payments received between 1 October 2000 and 30 September 2005.

This Ruling is signed by me on the 18th day of April 2001.

**Martin Smith**  
General Manager (Adjudication & Rulings)

## COMMENTARY ON PUBLIC RULING BR Pub 01/04

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 01/04 (“the Ruling”).

The subject matter covered in the Ruling was previously dealt with in Public Rulings BR Pub 97/3 and 97/3A published in TIB Volume 9, No 3 (March 1997) at page 7. The Ruling applies for the period from 1 October 2000 to 30 September 2005.

### Background

The Employment Relations Act 2000 provides for a number of remedies when an employee has a personal grievance against a current or former employer. This includes compensation for humiliation, loss of dignity, or injury to the feelings of the employee.

The Employment Relations Act also establishes specialist institutions with exclusive jurisdiction to deal with the rights of parties litigating on employment contracts: the Employment Relations Authority and the Employment Court. The Employment Relations Service of the Department of Labour has jurisdiction to provide mediation services.

Section 103(1) of the Employment Relations Act defines “personal grievance” as:

For the purposes of this Act, personal grievance means any grievance that an employee may have against the employee's employer or former employer because of a claim—

- (a) that the employee has been unjustifiably dismissed; or
- (b) that the employee's employment, or 1 or more conditions of the employee's employment (including any condition that survives termination of the employment), is or are or was (during employment that has since been terminated) affected to the employee's disadvantage by some unjustifiable action by the employer; or
- (c) that the employee has been discriminated against in the employee's employment; or
- (d) that the employee has been sexually harassed in the employee's employment; or
- (e) that the employee has been racially harassed in the employee's employment; or
- (f) that the employee has been subject to duress in the employee's employment in relation to membership or non-membership of a union or employees organisation.

Section 123 of the Employment Relations Act provides a number of remedies available to the Authority or Court when the Authority or Court determines that an employee has a “personal grievance” including:

...

- (b) the reimbursement to the employee of a sum equal to the whole or any part of the wages or other money lost by the employee as a result of the grievance:
- (c) the payment to the employee of compensation by the employee's employer, including compensation for -
  - (i) humiliation, loss of dignity, and injury to the feelings of the employee; and
  - (ii) loss of any benefit, whether or not of a monetary kind, which the employee might reasonably have been expected to obtain if the personal grievance had not arisen:

The Ruling considers whether such payments for humiliation, loss of dignity, or injury to the feelings of the employee are “monetary remuneration”. Paragraph (a) of the definition of “monetary remuneration” in section OB 1 states:

“Monetary remuneration” ...means any salary, wage, allowance, bonus, gratuity, extra salary, compensation for loss of office or employment, emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer;...

Section CH 3 states that “all monetary remuneration derived by a person is gross income”.

Section CD 5 also states that “the gross income of a person includes any amount that is included in gross income under ordinary concepts”.

### **Application of the Legislation**

If payments for humiliation, loss of dignity, or injury to feelings, under section 123(c)(i) of the Employment Relations Act 2000 are “monetary remuneration”, they would be included under section CH 3 as gross income. They would be included in the calculation of “net income” under section BC 6 and would consequently form part of “taxable income” as calculated under section BC 7.

Section OB 1 defines “monetary remuneration” to include any “other benefit in money, in respect of or in relation to the employment or service of the taxpayer...”.

Payments under section 123(c)(i) of the Employment Relations Act are a benefit in money. The issue is, therefore, whether these payments are made “in respect of or in relation to the employment or service of” the recipient.

### ***The meaning of “in respect of or in relation to”***

The phrase “in respect of or in relation to” is capable of having a very wide meaning. For example, in *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11,303, the Court of Appeal was dealing with certain lump sum payments made by Shell to employees who transferred at the request of Shell. The Court discussed the definition of “monetary remuneration”. The case concerned the part of the definition of “monetary remuneration” which says:

... emolument (of whatever kind), or other benefit in money in respect of or in relation to the employment or service of the taxpayer.

McKay J, delivering the judgment of the Court, said at page 11,306 that:

The words “in respect of or in relation to” are words of the widest import.

Although McKay J acknowledged that the payments in *Shell* were not made under the contract of employment in that case, this did not mean that the employees received the payment outside the employment relationship. The learned Judge had earlier referred to the fact that the payments were not expressly provided under the employees’ written employment contracts but were made pursuant to Shell’s employment policy as a matter of discretion. They were still made “because he or she is an employee”.

Other cases have also stressed the width of the words “in respect of or in relation to”. In the Queens Bench case of *Paterson v Chadwick* [1974] 2 All ER 772, Boreham J considered the meaning of the phrase “in respect of” in relation to discovery, and adopted the comments of Mann CJ in the Australian case *Trustees, Executors & Agency Co Ltd v Reilly* [1941] VLR 110, where the learned Chief Justice said:

The words “in respect of” are difficult of definition but they have the widest possible meaning of any expression intended to convey some connection or relation in between the two subject-matters to which the words refer.

Similarly, in *Nowegijick v The Queen* [1983] CTC 20 at page 25, the Supreme Court of Canada described the phrase “in respect of” as “probably the widest of any expression intended to convey some connection between two related subject-matters”.

### **Context may affect the meaning**

However, many cases have demonstrated that the meaning to be given to the phrase “in respect of or in relation to” may vary according to the context in which it appears.

In *State Government Insurance Office v Rees* (1979) 144 CLR 549, the High Court of Australia considered the meaning of the phrase “in respect of” in determining whether the debt due to the Government Insurance Office fell within section 292(1)(c) of the Companies Act 1961-1975 (Q.) as “amounts ... due in respect of workers’ compensation under any law relating to workers’ compensation accrued before the relevant date”. The Court held that amounts which could be recovered by the Government Insurance Office from an uninsured company pursuant to section 8(5) of the Workers’ Compensation Act 1916-1974(Q.) for money paid to workers employed by the uninsured company were **not** amounts due “in respect of” workers’ compensation under the Companies Act.

At page 561 Mason J observed that:

... as with other words and expressions, the meaning to be ascribed to “in respect of” depends very much on the context in which it is found.

Stephen J also discussed the meaning of the phrase “in respect of”, noting at pages 553-554 that it was capable of describing relationships over a very wide range of proximity, and went on to say:

Were the phrase devoid of significant context, it could, I think, be taken to be descriptive of the relationship between the present indebtedness owed to the State Government Insurance Office and the subject matter of workers’ compensation. However a context does exist which is in my view sufficient to confine the operation of s 292(1)(c) to bounds too narrow to be of service to the appellant.

In *TRA Case R34* (1994) 16 NZTC 6,190, certain payments were made to a New Zealand distributor by its overseas parent in relation to repairs which had to be made to cars sold to the New Zealand subsidiary and then sold to dealers. The issue was whether the payments were zero-rated. The definition of “consideration” in section 2 of the Goods and Services Tax Act 1985 was relevant. Part of the definition of “consideration” states:

...any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services ...

The TRA stated at page 6,200 that:

A sub-issue is whether the reimbursing payment from the overseas manufacturer (MC) was made “in respect of, in response to, or for the inducement of” the repair work in the sense required by the definition of “consideration” in s 2 of the Act. ... Although the definition of consideration creates a very wide potential link between a payment and a particular supply it is, in any case, a matter of degree, commonsense, and commercial reality whether a payment is direct enough to have the necessary nexus with a service, i.e., whether the link is strong enough.

The High Court’s decision on the appeal of *Case R34* is *CIR v Suzuki New Zealand Ltd* (2000) 19 NZTC 15,819. McGechan J said:

...it is necessary there be a genuine connection. The legislature is not to be taken as taxing on an unrealistic or tenuous connection basis.

***Not all payments to employees are “monetary remuneration”***

While it is true that an employee would not receive a payment under section 123(c)(i) of the Employment Relations Act if he or she were not an employee, it would seem clear that this type of “but for” approach to “in respect of or in relation to” is not universally applied in the context of employment, and that not all payments to employees which have a connection with their work are within the definition of “monetary remuneration”. In *Fraser v CIR* (1995) 17 NZTC 12,356, at page 12,363, Doogue J in the High Court said:

There is no dispute that the words “emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer” are words of the widest possible scope: see *Shell New Zealand Ltd v C of IR* (1994) 16 NZTC 11,303 at p 11,306, and *Smith v FC of T* 87 ATC 4883; (1987) 164 CLR 513; (1987) 19 ATR 274. Mr Harley does, however, submit, correctly, that it does not follow that all payments made are necessarily income and refers, for example, to reimbursement payments.

In *Shell*, McKay J highlighted the fact that the payments in that case were **both**:

- made to the recipients because they were employees; **and**
- paid to compensate for the loss incurred by the employee in having to relocate in order to take up a new position with the employer.

Many cases have concluded that, in appropriate circumstances, amounts received were not income, or assessable, even though paid by an employer to an employee.

In *FC of T v Rowe* (1995) ATC 4,691, for example, the taxpayer was employed as an engineer for the Livingston Shire Council. As a result of a number of complaints against him he was suspended. An inquiry was commenced, and he incurred legal costs as a result of engaging counsel to defend himself against dismissal during the course of the inquiry. The taxpayer was cleared of any charges of misconduct but was dismissed a year later. The taxpayer claimed his legal costs as a deduction. Although the Council refused to reimburse the taxpayer for his legal costs, the Queensland government subsequently made an ex gratia payment to him.

The Full Federal Court considered, amongst other things, whether the ex gratia payment constituted assessable income. By majority, the Court concluded that the payment was not assessable under section 25(1) of the Australian Income Tax Assessment Act 1936 as income in accordance with ordinary concepts, nor was it assessable under section 26(e) of that Act as being compensation “in respect of, or for or in relation directly or indirectly to” any employment. Accordingly, Burchett and Drummond JJ (with Beaumont J dissenting) held that the payment was not assessable. Burchett J held that the payment was **not a reward for the taxpayer’s services but was a recognition for the wrong done to him**. The payments were not remuneration but a reparation, and they were not sufficiently related to the performance of income-earning activities. On the same reasoning, it was too remote from the employment to be caught by section 26(e). Further, the payment was not assessable under section 26(e) because the employer/employee relationship between the Council and the taxpayer was **merely part of the background facts** against which the ex gratia payment was made. On appeal, the majority of the Full High Court confirmed the Federal Court’s decision: *FC of T v Rowe* (1997) ATC 4,317.

Other cases, relating to wartime service, have also shown that payments made to present or former employees for reasons unconnected with their service as an employee will not necessarily be assessable income on a “but for” basis. In *Louisson v Commissioner of Taxes* [1943] NZLR 1, at page 9 Myers CJ and Northcroft J said of payments made by an employer to a former employee who had enlisted in the New Zealand Expeditionary Force in World War II:

In our opinion, such payments were personal gifts to each of the employees coming within the description in the resolution - gifts made simply as an acknowledgment of personal appreciation of the sacrifice made in the service of the Country by persons whose employment with the company has ceased and who are under no engagement to return to that employment.

Similarly, in the Australian case of *FCT v Dixon* (1954) 5 AITR 443, the taxpayer received payments from his prior employer topping up his military pay. It would appear from the judgment that the Australian Commissioner argued that even a slight relationship to employment was sufficient to satisfy the test in section 26(e) of the Australian Income Tax Assessment Act 1936 [which made assessable certain sums granted to the taxpayer “in respect of, or for or in relation directly or indirectly to, any employment...”]. This argument was rejected by Dixon CJ and Williams J, who stated at page 446 that:

We are not prepared to give effect to this view of the operation of s.26(e) ... There can, of course, be no doubt that the sum of £104 represented an allowance, gratuity or benefit allowed or given to the taxpayer by Macdonald, Hamilton and Company. Our difficulty is in agreeing with the view that it was allowed or given to him in respect of, or in relation directly or indirectly to, any employment of, or services rendered by him ... We are not prepared to give s.26(e) a construction which makes it unnecessary that the allowance, gratuity, compensation, benefit, bonus or premium shall in any sense be a recompense or consequence of the continued or contemporaneous existence of the relation of employer and employee or a reward for services rendered given either during the employment or at or in consequence of its termination.

In the same case, at page 450, McTiernan J stated that:

The words of paragraph (e) are wide, but, I think, not wide enough to prevent an employer from giving money or money’s worth to an employee continuing in his service or leaving it, without incurring liability to tax in respect of the gift. The relationship of employer and employee is a matter of contract. The contractual

relations are not so total and all embracing that there cannot be personal or social relations between employer and employee. A payment arising from those relations may have no connexion with the donee's employment.

These principles have also been applied by the courts in cases involving contracts for services. In *Scott v FCT* (1969) 10 AITR 367, Windeyer J in the High Court of Australia, considered the meaning of the words "in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him" in section 26(e) of the Income Tax and Social Services Contribution Assessment Act 1936-1961. The case concerned a solicitor who received a gift of £10,000 from a grateful client. Windeyer J stated at page 374 that the meaning of the words of the legislation "must be sought in the nature of the topic concerning which they are used". Windeyer J at page 376 referred to a passage from the judgment of Kitto J in *Squatting Investment Co Ltd v FCT* (1953) 5 AITR 496, at 524, where Kitto J (speaking of certain English cases) said:

The distinction these decisions have drawn between taxable and non-taxable gifts is the distinction between, on the one hand, gifts made in relation to some activity or occupation of the donee of an income-producing character ... and, on the other hand, gifts referable to the attitude of the donor personally to the donee personally.

Adopting this as a general principle, his Honour held that the £10,000 was not given or received as remuneration for services rendered and it did not form part of the taxpayer's assessable income.

A recent case discusses the words "in respect of the employment" in the Australian FBT legislation: *J & G Knowles & Associates Pty Ltd v FC of T* (2000) ATC 4,151. The case concerned interest-free loans to directors of a corporate trustee. Units in the trust fund were held by discretionary family trusts established by the directors. The lower courts were satisfied by a causal relationship, or a discernible and rational link between the loans and each director's employment. However, the Full Federal Court said that there had to be more than just *any* causal relationship between the benefit and the employment: the link had to be *sufficient* or *material*.

### ***The nature and context of the payments***

Looking at the nature and context of payments contemplated by section 123(c)(i), it is strongly arguable that they do not intrinsically result from the employee and employer relationship. It is true that if the employee were not an employee then there would be no entitlement to receive the payment, but payments under section 123(c)(i) of the Employment Relations Act for humiliation, loss of dignity, or injury to feelings are **not** compensation for services rendered or for actions that occur in the normal course of the employment relationship. They are based on the existence of a personal grievance.

Provisions for such compensation can be seen as being included in the Employment Relations Act because the sometimes unequal power of the parties to the employment contract means that such personal grievances may be likely to occur in that setting. It is noteworthy that the Human Rights Act 1993 also includes provisions for dealing with discrimination and sexual harassment of employees, even though that is not "employment legislation" at all.



It is also possible to analyse a breach of the terms of the employment contract giving rise to the personal grievance (and the subsequent compensation) as literally being outside the employment contract because of the breach of the terms of the contract.

Payments of compensation under section 123(c)(i) of the Employment Relations Act differ markedly from the situation in *Shell v CIR*. In that case at page 11,306, McKay J said:

It is true ...that the payment is not made under the contract of employment...It is nevertheless paid to an employee only because he or she is an employee, **and** is paid to compensate for the loss incurred in having to change the employee's place of residence in order to take up a new position in the company. (Emphasis added)

Thus, in the *Shell* case, the employees received the payments as employees, **and** in order to compensate for the loss sustained as a result of the employment-related relocation.

In the ordinary course, the Commissioner considers genuine payments under section 123(c)(i) to be too remote from the employment relationship to be within the definition of monetary remuneration. The Commissioner considers that the employment relationship in such instances is merely part of the background facts against which the compensation payments are made. The payments are not made "in respect of or in relation to the employment or service of the taxpayer".

At first glance, it may be thought that this approach conflicts with the outcome in *Case L78* (1989) 11 NZTC 1,451, where Barber DJ held that an *ex gratia* payment, to compensate for the employer's failure to give adequate notice of redundancy, was assessable as "monetary remuneration". However, the result in that case turned substantially on the objector's evidence as to the receipt being in the nature of "extra wages". Barber DJ stated at page 1,455 that:

The objector himself related the \$7,009.52 to extra holiday pay and sick leave. ... At the end of his cross-examination he said that it was "really a bonus" and he regarded \$7,009.52 as "extra wages". The character of the payment must be of a revenue nature. It is not a payment in the nature of capital. I consider that it is clearly within the definition of monetary remuneration in sec 2.

There is also the later TRA decision in *Case L92* (1989) 11 NZTC 1,530, where Barber DJ again considered the definition of "monetary remuneration". This case also concerned an employee who was made redundant and an employer who did not comply with the requirement to give adequate notice. Barber DJ held that the payment came within the definition of "monetary remuneration" and was assessable income. However, the Authority did not consider any cases (other than his own previous decision in *Case L78*) on the correct characterisation of receipts for tax purposes, but rather concentrated upon the need to interpret "monetary remuneration" in a "wide manner" and the fact that the amount was received as compensation for loss of employment. Such compensation is specifically referred to in the definition of monetary remuneration. Recognising that it was possible for some receipts of a capital nature to be assessable income under a specific provision, Barber DJ at page 1,537 stated:

In this case, the words in sec 2 “compensation for loss of office or employment, emolument (of whatever kind), or other benefit in money” must surely cover not only a revenue type of payment such as a payment for lost wages, but also any other form of compensation for loss of employment.

It may also be relevant to observe that both of these TRA decisions concerned settlements under the Industrial Relations Act 1973. This earlier legislation made no specific and separate provision for compensation payments for humiliation, loss of dignity, or injury to feelings.

It is also thought that payments of the type under consideration in this Ruling are to be distinguished from those considered in American cases such as the *Commissioner v Schleier* 95-USTC 50,309. In that case, the United States Supreme Court held that certain punitive damages were assessable to the recipient employee. However, apart from the differing statutory context in the United States Internal Revenue Code, these damages were punitive because they related to a deliberate breach of the Age Discrimination in Employment Act and that Act does not provide for a separate recovery of compensatory damages for pain and suffering or emotional distress. The New Zealand Court of Appeal in *Air New Zealand Ltd v Johnston* [1992] 1 NZLR 159 seemingly rejected the view that humiliation type payments to employees are punitive in nature rather than compensatory. In that case Cooke J held at page 168 that “the emphasis evidently placed by the Labour Court on the punitive aspect does justify, in my opinion, a radical interference with their award.” The award of \$135,000 was replaced with one of \$25,000, made up of \$15,000 for future economic loss and \$10,000 for injury to feelings.

### ***Income under ordinary concepts***

Compensation payments genuinely made under section 123(c)(i) of the Employment Relations Act 2000 are not “gross income under ordinary concepts” under section CD 5. Unlike the statutory definition of “monetary remuneration”, section CD 5 can only apply when the payments received are “income” according to ordinary concepts.

Although the legislation does not define “gross income under ordinary concepts”, a great number of decided cases has variously identified the concept by reference to such characteristics as periodicity, recurrence, and regularity, or by its resulting from business activities, the deliberate seeking of profit, or the performance of services. Nor do capital receipts form part of “gross income” unless there is a specific legislative provision to the contrary. It is clear that payments under section 123(c)(i) will not generally be made periodically or regularly, or generally recur. Nor as we have seen above, are they compensation for services. And by analogy with common law damages, they are of a capital nature.

This point is acknowledged by Barber DJ in *Case L92*, where he stated at page 1,536 that:

I appreciate only too well that it is possible to interpret the evidence as showing that the \$7,179.30 was formulated as a payment in the nature of common law damages for human hurt and breach and unfairness... I appreciate that the latter concepts are akin more to payments of capital than to wage revenue.

### ***Out of court settlements***

Sometimes, an employee and an employer negotiate a settlement out of court. The settlement agreement may state that the payment is for humiliation, loss of dignity, or injury to feelings. In return for the employee surrendering his or her rights under the Employment Relations Act, the employer will agree to pay a sum of money. There should be no difference in the tax treatment of the payments dependent on whether or not the parties use the Employment Relations Authority or Employment Court. A payment can be for humiliation, loss of dignity, or injury to the feelings of the employee whether the Authority or Court are involved or not.

### *Shams*

The Ruling will not apply to payments which are akin to sham payments. A sham is a transaction set up to conceal the true intention of the parties and is inherently ineffective. The nature of a sham was discussed by Diplock LJ in *Snook v London and West Riding Investment Ltd* [1967] 1 All ER 518 at 528 where he stated:

I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the “sham”, which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

Richardson J, in the New Zealand case of *Mills v Dowdall* [1983] NZLR 154, stated that the “essential genuineness of the transaction is challenged” in a sham situation.

It is noteworthy that in the Taxation Review Authority decision *Case S 96* (1996) 17 NZTC 7,603, Judge Barber stated at page 7,606:

Of course, seemingly excessive allocations to compensation for feelings injury should be reopened by the IRD.

If the parties to an agreement agree to characterise or describe payments as being for humiliation, loss of dignity, or injury to feelings when they are in reality for lost wages, this transaction would be a sham which would be open to challenge by the Commissioner. Where the Commissioner has some doubt about the amount attributed to humiliation, loss of dignity, or injury to feelings, he may ask the parties to an agreement what steps they took to evaluate objectively what would be a reasonable amount to attribute to humiliation, loss of dignity, or injury to feelings. This would be so regardless of whether the payment was made as a result of an out of court settlement and whether or not the agreement is signed by a mediator under the Employment Relations Act. Further, as provided by section 18 of the Taxation Review Authorities Act 1994 and section 136(16) of the Tax Administration Act 1994, the onus of proof in a hearing regarding the assessability of any such payment would be on the taxpayer.