Inland Revenue
Te Tari Taake

EMPLOYMENT COURT AWARDS FOR LOST WAGES OR OTHER REMUNERATION - EMPLOYERS' LIABILITY TO MAKE TAX DEDUCTIONS

PUBLIC RULING BR Pub 01/06

Note (not part of ruling): This ruling replaces Public Rulings BR Pub 97/7 and 97/7A published in TIB Volume 9, No 6 (June 1997). This new ruling is essentially the same as the previous rulings. The main changes take into account the new employment legislation and tax law amendments, and update relevant case references. 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 CH 3, EB 1, NC 2, NC 16 , OB 1 (definitions of "employee", "extra emolument", "monetary remuneration", and "shareholder-employee"), and OB 2 (definition of "source deduction payment").

The Arrangement to which this Ruling applies

The Arrangement is an order by the Employment Court or the Employment Relations Authority requiring an employer to make a payment for lost wages or other remuneration to an employee under the Employment Relations Act 2000.

The Court or Authority will make such an award when an employee has lost wages or other remuneration as a result of an action by the employer which has been the subject of a personal grievance by the employee against the employer (e.g. unjustifiable dismissal or other unjustifiable action by the employer). An award for lost wages or other remuneration will usually be made under sections 123(b) or 128 of the Employment Relations Act, but may be made under another provision.

This Ruling does not apply to an award of compensation for humiliation, loss of dignity, or injury to feelings made under section 123(c)(i) of the Employment Relations Act.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

A. Monetary remuneration

The payment of an award for lost wages or other remuneration under the Employment Relations Act 2000 is "monetary remuneration" of the employee as defined in section

OB 1. As the payment is monetary remuneration, it is gross income of the employee under section CH 3.

B. Employer's liability to make tax deductions from the award

The payment of an award for lost wages or other remuneration under the Employment Relations Act 2000 is an extra emolument and is a "source deduction payment" under section OB 2 (1). The employer must make tax deductions from the payment under section NC 2 and account for those deductions to Inland Revenue in the normal way.

If an employer fails to make the required tax deductions from a payment, the employee is liable, under section NC 16, to pay an amount equal to those tax deductions to the Commissioner (and is also required to furnish to the Commissioner an employer monthly schedule showing details of the payment).

C. When the payment is derived by the employee

Under section EB 1 (1), an employee derives a payment of an award for lost wages or other remuneration under the Employment Relations Act 2000 when the employee receives the payment, or when the payment is credited to an account or otherwise dealt with on the employee's behalf.

A person who is a shareholder-employee for the purposes of section EB 1 (as defined in sections OB 1 and OB 2 (2)) derives a payment of an award for lost wages or other remuneration under the Employment Relations Act 2000, in the income year that the expenditure on that award is deductible to the employer. If the expenditure on the award is not deductible to the employer, the shareholder-employee derives the award in the year of receipt.

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 12th day of June 2001.

Martin Smith
General Manager (Adjudication & Rulings)

COMMENTARY ON PUBLIC RULING BR Pub 01/06

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 01/06 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Rulings BR Pub 97/7 and 97/7A published in TIB Volume 9, No 6 (June 1997). The Ruling applies for the period from 1 October 2000 to 30 September 2005.

The commentary refers to the Income Tax Act 1994, particularly section CH 3 and the concept of "gross income".

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 wages lost by the employee as a result of actions by the employer which are the subject of a personal grievance. Such compensation will usually be awarded under sections 123(b) or 128 of the Act but may be made under another provision.

For example, in *Cleland v CIR* AP 44/00 High Court, Hamilton, 30 April 2001, Hammond J was concerned with the assessability of part of an award made by the Employment Court in 1992. The Employment Court awarded compensation for lost wages up to the date of hearing under the equivalent of section 128 of the Employment Relations Act. An award for lost wages from that date on was made under the equivalent of section 123(c)(ii) which provides for compensation for the loss of a benefit. The law in this area seems to be evolving and while awards for lost wages or other remuneration are now generally made under section 123(b), the Ruling will apply under whatever provision such an award is made.

This Ruling confirms the Commissioner's existing practice in respect of the assessability and deduction of tax from awards for lost wages or other remuneration made under the Employment Relations Act 2000.

Legislation

Relevant provisions of the Employment Relations Act 2000

Section 103 of the Employment Relations Act 2000 ("the ERA") 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’semployment in relation to membership or non-membership of a union or employees organisation.

Section 103(3) provides:

In subsection (1)(b), unjustifiable action by the employer does not include an action deriving solely from the interpretation, application, or operation, or disputed interpretation, application, or operation, of any provision of any employment agreement.

Section 123(b) of the ERA states:

Where the Authority or the Court determines that an employee has a personal grievance, it may, in settling the grievance, provide for any 1 or more of the following remedies:
…
(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 ...

Section 128 of the ERA states:

(1) This section applies where the Authority or Court determines, in respect of any employee, -

(a) that the employee has a personal grievance; and

(b) that the employee has lost remuneration as a result of the personal grievance.

(2) If this section applies then, subject to subsection (3) and section 124, the Authority must, whether or not it provides for any of the other remedies provided for in section 123, order the employer to pay to the employee the lesser of a sum equal to that lost remuneration or to 3 months’ ordinary time remuneration.

(3) Despite subsection (2), the Authority may, in its discretion, order an employer to pay to an employee by way of compensation for remuneration lost by that employee as a result of the personal grievance, a sum greater than that to which an order under that subsection may relate.

Section 124 of the ERA states:

Where the Authority or the Court determines that an employee has a personal grievance, the Authority or Court must, in deciding both the nature and the extent of the remedies to be provided in respect of that personal grievance,—
(a) consider the extent to which the actions of the employee contributed towards the situation that gave rise to the personal grievance; and
(b) if those actions so require, reduce the remedies that would otherwise have been awarded accordingly.

Application of the Legislation

Monetary remuneration

An award for lost wages or other remuneration is made to compensate the employee for wages or other remuneration he or she may have lost as a result of an action by the employer which has been the subject of a personal grievance by the employee against the employer. The wages or other remuneration that would have been received if it were not for the personal grievance are "monetary remuneration". Section OB 1 defines "monetary remuneration" as meaning:

> … 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 ...

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 ..." cover an award for lost wages or other remuneration. The payment of the award for lost wages or other remuneration is made "in respect of or in relation to the employment or service of the taxpayer", even though the payment is made to resolve a personal grievance rather than for services actually performed.

A wide interpretation of the words "in respect of or in relation to the employment or service" was endorsed by the Court of Appeal in *Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303, in response to Shell's argument that a payment was not made in respect of or in relation to employment because it was not made under a contract of employment. The Court stated that the words "in respect of or in relation to" are words of the widest import. The Court also found that the words "emolument (of whatever kind), or other benefit in money" were not to be read ejusdem generis with the preceding words, the genus being reward for services. Thus, for the purposes of the definition of "monetary remuneration", the words "emolument ... or other benefit in money" are not confined to rewards for services.

In *Shell* the Court found it important that the employees were only in a position to receive compensation payments (for changing the employees' place of employment) because of their employment relationship with the employer. So, although the employees received compensation for the costs of moving rather than payments for services, this was still monetary remuneration. Similarly, the lost wages or other remuneration awarded on the personal grievance claim arise directly out of and as a result of an employee's employment relationship with the employer. Again, although this is not a payment for services, it is within the definition of "monetary remuneration".

The earlier TRA decisions on the previous legislation also illustrate the wide meaning that may be attributed to the words "in respect of or in relation to the employment or service of the taxpayer". In *Case L92* (1989) 11 NZTC 1,530, Barber DJ considered the term "monetary remuneration" in relation to a payment of compensation for unjustified dismissal under the Industrial Relations Act 1973. The compensation was calculated on the basis of the personal hurt and procedural unfairness suffered by the objector. Barber DJ found that, even though the compensation was damages in nature,

it was money received in respect of the objector's employment. He stated that the words "compensation for loss of office or employment", "emolument (of whatever kind), or other benefit in money" and "in respect of or in relation to the employment or service of the taxpayer" have a wide embrace and go beyond the narrower concept of "salary, wage, allowance, bonus gratuity, extra salary" which precede them. On the particular facts of this case he said that "monetary remuneration", interpreted widely, covered the payment in issue.

Barber DJ reached the same conclusion in relation to a similar compensation payment in *Case L78* (1989) 11 NZTC 1,451. This case examined the nature of an ex gratia payment made to an employee as a result of a personal grievance claim brought against the employer under section 117 of the Industrial Relations Act 1973 which covered reimbursement for lost wages. The ex gratia payment was made up of six weeks' holiday pay and pay for untaken sick leave. This holiday and sick leave was not owing to the taxpayer. The payment, which the taxpayer said he regarded as "extra wages", was held to fall within the definition of "monetary remuneration" in section 2 of that Act.

In *Case P19* (1992) 14 NZTC 4,127, Barber DJ examined whether a severance payment of $77,598 paid to an objector by his overseas employer was assessable income. The objector was a jockey who entered into a three-year oral contract to ride his employer's horses. The employer became dissatisfied with the objector's performance and unilaterally terminated the contract after about 4 months. After negotiation, the matter was settled on the basis that the employer made the severance payment. Barber DJ held that "the severance payment was made as compensation for the objector's loss of income due to the millionaire having terminated the contractual relationship". He inferred that "the payment was a top-up of the first year's minimum income" made to "assist the objector re-build his income earning process" and said that that type of payment "must be revenue in nature". He stated that:

> In terms of the definition of "monetary remuneration", the payment made to the objector must be "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;"

Although not concerning a Court award, *Case P19* supports the proposition that payments made as compensation for loss of income fall within the definition of monetary remuneration.

In *Case S96* (1996) 17 NZTC 7,603 and *Case U38* (2000) 19 NZTC 9,361 the taxpayers in each case did not dispute that the portion of their compensation payment that was for lost wages was taxable, and this was accepted by the TRA. Doogue J in the High Court decision in *Sayer v CIR* (1999) 19 NZTC 15,249 also accepted the assessability of the part of a settlement agreement attributed to lost remuneration.

In *Case U39* (2000) 19 NZTC 9,369 an IRD officer was awarded compensation of $126,000 being $46,000 (loss of wages), $30,000 (humiliation), and $50,000 (loss of benefits) by the Employment Court in 1992. The Commissioner accepted that the humiliation payment was not assessable and assessed the balance of $96,000.

Barber DJ readily found that the compensation for lost wages was monetary remuneration, and so was the compensation for loss of benefits. He said (at paragraph 26, p 9,374):

> Awards made by the Employment Court pursuant to ss 227(c)(ii) above and 229 (for lost income) of the Labour Relations Act 1987 are generally deemed to be "monetary remuneration" and assessable income pursuant to s 65(2)(b) of the Income Tax Act 1976. Indeed, because awards under s 229 are a reimbursement of, or compensation for, "lost remuneration" for the worker, any such award (in this case $50,000 [sic] of the $96,000 in issue) must, obviously, be revenue in character and within the above s 2 (of the Act) definition of "monetary remuneration", and assessable.

(Section 128 of the Employment Relations Act 2000 is the equivalent of section 229 of the Labour Relations Act).

In his decision on appeal dated 30 April 2001, Hammond J upheld the TRA's decision: *Cleland v CIR* AP44/00 High Court, Hamilton. He found that the reimbursement of lost wages was "monetary remuneration", saying, at paragraph 41:

> I cannot see how the loss of wages due up to the date of hearing under s229 ($46,000) is not "monetary remuneration" under s2 of the Income Tax Act 1976.

He went on to find that the $50,000 awarded by the Employment Court under section 227(c)(ii) for loss of benefits, which included an element of future wages, was also assessable as "monetary remuneration".

As noted earlier in this commentary, the law in this area seems to have moved on from requiring a division of awards of lost wages between those up to the date of the hearing (under the reimbursement remedy), and those from that date on (under the loss of benefits remedy). Compensation for lost wages, including those that the employee would have been likely to receive over some future period but for the grievance, are generally awarded under section 123(b) of the Employment Relations Act. See for example *Trotter v Telecom Corporation of NZ Ltd* [1993] 2 NZER 659.

These cases clearly indicate that an award for lost wages or other remuneration is assessable as monetary remuneration. All monetary remuneration is gross income of the employee.

When the employment relationship has ended

In some cases the employment relationship of the employer and employee will have ended by the time the employer pays the court award to the employee. The fact that the employment relationship may have ended by the time the employer pays the award does not change the fact that the award is made "in respect of or in relation to the employment or service" of the former employee. In *Freeman & Ors. v FC of T* (1982) 82 ATC 4629 the Supreme Court of Victoria found that a payment is made "in relation to the employment" of a former employee when the entitlement to that payment arises out of the employment or from services performed by the employee before the termination of employment.

In *Freeman* the taxpayers were directors, shareholders, and employees of the appellant company which ceased to carry on business. The next day the business was

sold to another company controlled by the taxpayers and carried on business as before. Six months later it was decided that the appellant company should pay to each of the taxpayers certain lump sum payments. The evidence suggested that the source of the greater part of the payments consisted of fees (or "salaries") received by the appellant company after it ceased carrying on business. The Court found that the payments received by the appellants were assessable income under section 26(e) of the Income Tax Assessment Act 1936-1978. Section 26(e) provided that assessable income included the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums given to him or her in relation directly or indirectly to their employment or services rendered by him or her. Kaye J found that payments out of the income of the appellant company to employees by way of allowances for past services, which had been rendered by them, were within section 26(e). The decision on this aspect of the case was unchanged when the appeal was heard by the Federal Court.

Awards for lost wages or other remuneration arise out of the employee's previous service with the employer. A court award that compensates for lost wages or other remuneration is made as a result of the employee's service with the employer, and so is made in relation to the employment of the employee.

Employer's liability to make tax deductions from the award for lost wages or other remuneration

The Ruling states that the payment of an award for lost wages or other remuneration is a source deduction payment. Under section NC 2 (1), an employer must make the appropriate tax deduction from every source deduction payment made to an employee.

Award is a source deduction payment

The definition in section OB 2 (1) of "source deduction payment" includes a payment by way of salary or wages, an extra emolument, or a withholding payment.

Section OB 1 defines "extra emolument" as:

> ... in relation to any person, means a payment in a lump sum (whether paid in one lump sum or in 2 or more instalments) made to that person in respect of or in relation to the employment of that person (whether for a period of time or not), being a payment which is not regularly included in salary or wages payable to that person for a pay period, but not being overtime pay ...

An award for lost wages or other remuneration is generally paid in a lump sum. As discussed above, the payment of an award for lost wages or other remuneration is made to a person in respect of or in relation to the employment of that person. As the payment of an award for lost wages or other remuneration is made in a lump sum, is in respect of or in relation to employment of a person, and is not a payment of salary or wages, it is an extra emolument. As the payment of the award is an extra emolument, it is included in the definition of "source deduction payment".

A former employee is an "employee"

Section NC 2 requires an employer to make tax deductions from source deduction payments to employees. Section OB 1 defines "employee" as a person who receives or is entitled to receive a source deduction payment.

As discussed above, the payment of an award for lost wages or other remuneration constitutes a source deduction payment. A payment can still be "monetary remuneration" and a source deduction payment when it is paid to a former employee. A former employee who is entitled to receive this source deduction payment is also an "employee" for the purposes of section NC 2 (even though he or she may no longer be in an employment relationship with the employer).

The appropriate tax deduction

Section NC 2 requires the employer to make the appropriate tax deduction from source deduction payments to employees. As the payment of an award for lost wages or other remuneration constitutes an "extra emolument", the employer must deduct tax at the extra emolument rate as provided for in section NC 2(5) and clause 8 of Schedule 19. (This currently provides a minimum rate of 21 cents in the dollar, or 33 cents or 39 cents in the dollar depending on the recipient's income level, or on whether the recipient makes an election for a particular rate under section NC 8(1A).)

The employer must also:

- deduct ACC earner premium and earners' account levy from the payment; and
- account for the deductions to Inland Revenue in the normal way and pay the remaining amount to the employee; and
- pay employer premium and residual claims levy in respect of the gross award for lost wages or other remuneration.

By deducting tax from the gross award and paying the net sum to the employee, the employer will satisfy the requirements under both the court award and the Income Tax Act. When an employer has deducted tax from a source deduction payment, section NC 19 (a) deems the employer to have paid the amount deducted to the employee. Thus, the employer is deemed to have paid the total amount of the award to the employee for the purposes of satisfying the obligation imposed by the Court or Authority.

When the Court or Authority awards a net sum

In some cases a Court or Authority may make an award for lost wages or other remuneration net of tax, i.e. the sum that the employee would have received as remuneration after the deduction of tax. Because it is a "source deduction payment", in such cases the employer would normally "gross up" the award to take account of the PAYE, the ACC earner premium, and the earners' account levy. The employer is then required to pay the tax on the gross of the net award to Inland Revenue and pay

the net award to the employee. In this way the employer would fulfil his or her obligations to both the employee and the Commissioner.

If the employer breaches the Court's or the Authority's direction to pay the net sum to the employee, the onus will be on the employee to enforce the terms of the award by requiring the employer to pay the employee the full net amount of the award. The required tax deduction must be made from whatever amount is paid to the employee.

When an employer fails to make tax deductions

Under section 168 of the Tax Administration Act 1994, if the employer fails to make the correct tax deductions from the payment of the award, the unpaid tax deductions become a debt owed by the employer to the Commissioner. The debt is due and payable on the date that the tax deductions were due to be paid to the Commissioner.

Where an employer fails to make a deduction, the employee is liable, under section NC 16, to:

- furnish the Commissioner with an employer monthly schedule containing particulars of the source deduction payment (i.e. the award) by the 20th of the month following the payment of the award; and

- pay the Commissioner a sum equal to the tax deductions that the employer should have made on that source deduction payment (unless the employee is exempted from this requirement) by the 20th of the month following the payment of the award.

When the payment is derived by the shareholder-employee

Under section EB 1, a person is a shareholder-employee if he or she is a shareholder-employee in a close company and has met the criteria set out in section OB 2 (2).

Example 1

An employee is dismissed from her job. She issues proceedings against her former employer alleging unjustifiable dismissal. She seeks reinstatement and damages for wages lost as a result of the unjustifiable dismissal.

The Employment Relations Authority orders the employer to reinstate the employee and awards her $27,000, a sum equivalent to the employee's wages from the time of dismissal to the time of reinstatement, to compensate for the wages lost as a result of the unjustified dismissal.

The Authority makes the award for lost wages on 20 March 2001. The employer pays this award to the employee on 10 April 2001.

1. The award for lost wages is derived by the employee in the 2001-02 income year, as this is the year of receipt.

2. The employer must deduct tax and ACC earner premium and earners' account levy from the court award, and pay the following amounts to the employee and Inland Revenue respectively (in the 2002 income year):

Award for lost wages		$27,000
Less tax at the extra emolument rate, in this case 21%	$5,670	
Less ACC earner premium.($27,000 x 0.011)	$ 297	
Total payable to Inland Revenue		$ 5,967
Total payable to the employee		$21,033

Example 2

The facts are the same as in Example 1, except that the Authority awards damages of $27,000 and states that this sum is net of tax. In order to ensure that it pays the employee a net sum of $27,000, the employer "grosses up" the payment by the extra emolument tax rate plus ACC earner premium and levy. The employer should make the following calculations and payments:

Award for net lost wages	$27,000.00	
Divided by 0.779 (1 - 0.21 - 0.011) to give the gross wage		$34.659.82
Less tax at the extra emolument rate of 21%	$ 7,278.56	
Less ACC earner premium ($34,659.82 x 0.011)	$ 381.26	
Total payable to Inland Revenue		$ 7,659.82
Total payable to the employee		$27,000.00

In both examples:

- The employer must also pay the employer premium and residual claims levy on the gross award.

- Any other source deduction payments received by the employee from that employer in the 4 weeks prior to payment of the award must also be taken into account in calculating her annualised salary or wages and determining the appropriate tax deduction rate.

- If the employee is required to file an income tax return, she will include the amount of the award for lost wages in her return for the 2001-02 income year and claim the tax paid as a credit.