Inland Revenue
Te Tari Taake

TAXABILITY OF PAYMENTS UNDER THE HUMAN RIGHTS ACT 1993 FOR HUMILIATION, LOSS OF DIGNITY, AND INJURY TO FEELINGS

PUBLIC RULING—BR Pub 05/12

Note (not part of ruling): This ruling is essentially the same as Public Ruling BR Pub 01/09 published in *Tax Information Bulletin* Vol 13, No 11 (November 2001). However, the new ruling has been updated to take into account amendments to the Human Rights Act 1993 as a result of the Human Rights Amendment Act 2001. This new ruling also applies the Income Tax Act 2004, which came into force on 1 April 2005, rather than the Income Tax Act 1994 provisions. The changes between the 1994 and 2004 provisions affecting this ruling do not affect the conclusions previously reached.

The ruling applies for an indefinite period.

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 2004 unless otherwise stated.

This Ruling applies in respect of sections CA 1 and CE 1.

The Arrangement to which this Ruling applies

The Arrangement is:

- The payment of an award of damages to a complainant or aggrieved person as granted by the Human Rights Review Tribunal for humiliation, loss of dignity, and injury to feelings under section 92M(1)(c) of the Human Rights Act 1993, where the complaint involves an employer/employee relationship; or

- The making of a payment to a complainant or aggrieved person for humiliation, loss of dignity, and injury to feelings pursuant to an out of court settlement genuinely based on the complainant or aggrieved person's rights to damages under section 92M(1)(c) of the Human Rights Act 1993 where the complaint involves an employer/employee relationship.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Payments for damages or out of court settlements that are genuinely and entirely awarded for humiliation, loss of dignity, and injury to feelings under section

92M(1)(c) of the Human Rights Act 1993 are not income under section CE 1 of the Income Tax Act 2004.

- Payments for damages or out of court settlements that are genuinely and entirely awarded for humiliation, loss of dignity, and injury to feelings under section 92M(1)(c) of the Human Rights Act 1993 are not income under ordinary concepts under section CA 1(2).

The period for which this Ruling applies

This Ruling will apply to payments received on and after 1 April 2005 for an indefinite period.

This Ruling is signed by me on the 29th day of June 2005.

Susan Price
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Inland Revenue
Te Tari Taake

COMMENTARY ON PUBLIC RULING BR Pub 05/12

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 05/12 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 01/09 published in TIB Vol 13, No 11 (November 2001). This Ruling applies for an indefinite period.

Background

The Human Rights Act 1993 ("the HRA") provides protection for people against discrimination on the grounds of sex, marital status, religious or ethical belief, race, colour, ethnic or national origins, age, disability, political opinion, employment status, family status, and sexual orientation.

Under the Act people can make a complaint to the Human Rights Commission ("the Commission") regarding breaches of the provisions of the Act. If the Commission is unable to settle the complaint, the matter may proceed to the Human Rights Review Tribunal ("the Tribunal").

The Tribunal is an independent body that hears and determines complaints that have been made to the Commission. The Tribunal has the power of a court similar to the District Court, and its decisions can be enforced in the District Court if parties fail to comply with its orders or directions.

Significant changes were made to the HRA in 2001, including changes to the functions and powers of the Commission, the merging of the office of the Race Relations Conciliator with the Human Rights Commission and establishing the Office of Human Rights Proceedings. Changes were made to the way complaints are received and resolved. The Complaints Review Tribunal also became the Human Rights Review Tribunal following the amendments.

The Government's exemption from full compliance with the HRA also expired on 31 December 2001. The new Part 1A makes the Government, government agencies and anybody who performs a public function accountable, subject to certain exceptions, for unlawful discrimination.

There were certain consequential changes to the sections of the HRA referred to in BR Pub 01/09 and the Ruling now refers to the current sections.

Legislation

Section 92I of the HRA provides a number of remedies for the Tribunal when the Tribunal determines that a breach of any of the provisions of Part 1A and Part 2 of that

Act has been committed or where there has been a breach of the terms of a settlement of complaint. Section 92I of the HRA provides:

> **92I. Remedies—**
>
> (1) This section is subject to sections 92J and 92K (which relate to the only remedy that may be granted by the Tribunal if it finds that an enactment is in breach of Part 1A).
> (2) In proceedings before the Human Rights Review Tribunal brought under section 92B(1) or (4) or section 92E, the plaintiff may seek any of the remedies described in subsection (3) that the plaintiff thinks fit.
> (3) If, in proceedings referred to in subsection (2), the Tribunal is satisfied on the balance of probabilities that the defendant has committed a breach of Part 1A or Part 2 or the terms of a settlement of a complaint, the Tribunal may grant 1 or more of the following remedies:
>
> (a) a declaration that the defendant has committed a breach of Part 1A or Part 2 or the terms of a settlement of a complaint:
> (b) an order restraining the defendant from continuing or repeating the breach, or from engaging in, or causing or permitting others to engage in, conduct of the same kind as that constituting the breach, or conduct of any similar kind specified in the order:
> (c) damages in accordance with sections 92M to 92O:
> (d) an order that the defendant perform any acts specified in the order with a view to redressing any loss or damage suffered by the complainant or, as the case may be, the aggrieved person as a result of the breach:
> (e) a declaration that any contract entered into or performed in contravention of any provision of Part 1A or Part 2 is an illegal contract:
> (f) an order that the defendant undertake any specified training or any other programme, or implement any specified policy or programme, in order to assist or enable the defendant to comply with the provisions of this Act:
> (g) relief in accordance with the Illegal Contracts Act 1970 in respect of any such contract to which the defendant and the complainant or, as the case may be, the aggrieved person are parties:
> (h) any other relief the Tribunal thinks fit.
>
> (4) It is no defence to proceedings referred to in subsection (2) or subsection (5) that the breach was unintentional or without negligence on the part of the party against whom the complaint was made, but, subject to section 92P, the Tribunal must take the conduct of the parties into account in deciding what, if any, remedy to grant.
> (5) In proceedings before the Human Rights Review Tribunal brought, under section 92B(3), by the person against whom a complaint was made, that person may seek a declaration that he or she has not committed a breach of Part 1A or Part 2.

Section 92M(1) of the HRA provides the circumstances in which damages may be awarded under the Act, including damages payments for humiliation, loss of dignity, and injury to feelings:

> **92M. Damages—**
>
> (1) In any proceedings under section 92B(1) or (4) or section 92E, the Tribunal may award damages against the defendant for a breach of Part 1A or Part 2 or the terms of a settlement of a complaint in respect of any 1 or more of the following:

(a) pecuniary loss suffered as a result of, and expenses reasonably incurred by the complainant or, as the case may be, the aggrieved person for the purpose of, the transaction or activity out of which the breach arose:
(b) loss of any benefit, whether or not of a monetary kind, that the complainant or, as the case may be, the aggrieved person might reasonably have been expected to obtain but for the breach:
(c) humiliation, loss of dignity, and injury to the feelings of the complainant or, as the case may be, the aggrieved person.

(2) This section applies subject to sections 92J, 92N, and 92O.

Part 1A of the HRA provides for the compliance and accountability of the legislative, executive and judicial branches of the government of New Zealand; or by any person or body in the performance of any public function, power, or duty conferred or imposed on that person or body by or pursuant to law. Part 2 of the HRA sets out what constitutes "unlawful discrimination" under that Act. Section 21 of that Act sets out the general prohibited grounds of discrimination, and sections 22 to 74 go on to deal with discrimination in specific situations.

Section 92M(1) of the HRA also refers to "the breach of Part 1A or Part 2 or the terms of a settlement of a complaint". Section 83 of that Act provides that the "Commission must use its best endeavours to assist the parties to secure a settlement". "Settlement" is defined in that section to mean "the agreement of the parties concerned on actions that settle the matter, which may include the payment of compensation" and includes "a satisfactory assurance by the person to whom the complaint relates against the repetition of the conduct". Section 89 provides that a "settlement between parties to a complaint may be enforced by proceedings before the Tribunal brought under section 92B(4)" of the HRA, which provides:

92B. Civil proceedings arising from complaints—

…

(4) If parties to a complaint under section 76(2)(a) have reached a settlement of the complaint (whether through mediation or otherwise) but one of them is failing to observe a term of the settlement, another of them may bring proceedings before the Tribunal to enforce the settlement.

In respect of section 92M(1)(c) of the HRA, any such breach of a settlement of a complaint would equally relate to damages for humiliation, loss of dignity and injury to feelings.

The Ruling considers whether payments granted under section 92M(1)(c) of the HRA for humiliation, loss of dignity, and injury to the feelings of the employee are "amounts derived by a person in connection with their employment or service", for the purposes of section CE 1 or, alternatively income under ordinary concepts under section CA 1(2). Section CE 1 provides:

The following amounts derived by a person in connection with their employment or service are income of the person:

(a) salary or wages or an allowance, bonus, extra pay, or gratuity:
(b) expenditure on account of an employee that is expenditure on account of the person:

(c) the market value of board that the person receives in connection with their employment or service:
(d) a benefit received under a share purchase agreement:
(e) directors' fees:
(f) compensation for loss of employment or service:
(g) any other benefit in money.

Section CA 1(2) states that "[a]n amount is also income of a person if it is their income under ordinary concepts".

Application of the Legislation

If payments for humiliation, loss of dignity, and injury to feelings, under section 92M(1)(c) of the HRA were "amounts derived by a person in connection with their employment or service", they would be included under section CE 1 as income of the person.

Section CE 1(g) includes in income amounts that are "any other benefit in money", if they are "amounts derived by a person in connection with their employment or service". Payments under section 92M(1)(c) of the HRA are a benefit in money. The issue is, therefore, whether these payments are "amounts derived by a person in connection with their employment or service".

While many of the categories of discrimination in the HRA may relate, directly or indirectly, to an employer/employee relationship, it is clear that many of them are intended to apply to much wider situations. Consequently, in many instances of complaints under the HRA, payments awarded will be completely outside any employment relationship and will clearly not be, in respect of a recipient taxpayer, "in connection with their employment or service". In such cases payments under section 92M(1)(c) will not fall within the income of the person under section CE 1. The Ruling does not consider such situations.

However, it is likely that complaints heard by the Tribunal under the HRA will often involve an employee/employer relationship. The question to be answered in the Ruling, therefore, is whether payments under section 92M(1)(c) of the HRA where the complaint involves an employee/employer relationship are made "in connection with their employment or service".

Relationship with Income Tax Act 1994

The Income Tax Act 2004 introduces the concept of an amount received by a person "in connection with their employment or service" being income of a person. Previously, the 1994 Act referred to an amount being monetary remuneration, and thus gross income, if it was an amount derived by a person "in respect of or in relation to" their employment or service.

The wording of the 2004 Act provision is different to that in the 1994 Act. However, while the 2004 Act has replaced the 1994 Act, section YA 3(3) of the 2004 Act nevertheless provides that provisions of the 2004 Act are the provisions of the 1994 Act

in rewritten form. The provisions of the 2004 Act are intended to have the same effect as the corresponding provision of the 1994 Act. The exception is, pursuant to section YA 3(5), where an "identified policy change", as specified in schedule 22A, exists.

In this instance no identified policy change has been specified in schedule 22A. Therefore, the presumption is that the adoption of the term "in connection with" was not intended to give rise to an interpretation that differs from that which would apply if the term "in respect of or in relation to", as used in the definition of "monetary remuneration" under the 1994 Act, still applied. It is therefore relevant to consider the meaning of the phrase "in respect of or in relation to" in the interpretation of the phrase "in connection with" in this situation.

The meaning of "in connection with"

The phrase "in connection with" is not defined in the Act. However, it has been considered in other contexts.

In *Strachan v Marriott* [1995] 3 NZLR 272, Hardie Boys J stated, at page 279:

"In connection with" may signify no more than a relationship between one thing and another. The expression does not necessarily require that it be a causal relationship: *Our Town FM Pty Ltd v Australian Broadcasting Tribunal* (1987) 16 FCR 465, 479 per Wilcox J. But, as Davies J warned in *Hatfield v Health Insurance Commission* (1987) 15 FCR 487, at p 491:

> "Expressions such as 'relating to', 'in connection with' and 'in respect of' are commonly found in legislation but invariably raise problems of statutory interpretation. They are terms which fluctuate in operation from statute to statute.... The terms may have a very wide operation but they do not usually carry the widest possible ambit, for they are subject to the context in which they are used, to the words with which they are associated, and to the object or purpose of the statutory provision in which they appear."

In *Case E84*, Bathgate DJ noted at page 59,445:

It is a matter of degree whether, on the interpretation of a particular statute, there is a sufficient relationship between subject and object to come within the words "in connection with" or not. It is clear that no hard and fast rule can be or should be applied to the interpretation of the words "in connection with". Each case depends on its own facts and the particular statute under consideration.

In *Hatrick (A) & Co v R* [1923] AC 213, the Privy Council considered the meaning of "in connection with" in the context of section 10 of the Government Railway Act 1908, which empowered the Minister of Railways to fix charges to be paid for goods stored in any shed or store "in connection with a railway". Their Lordships stated, at page 225:

In the view of their Lordships these words cannot apply to something done on a space or in a building merely contiguous to or abutting upon a railway, even though it be the property of a railway; if the thing done forms no part of or has no connection with the property business or a railway, as a carrier of passengers and goods by rail, or in other words that the expression "in connection with a railway" means connect with, subserving and being ancillary to, the business of a railway as such carriers … These words … must be direct to something different from propinquity or contiguity, and in their Lordships' view, having regard to all the provisions of the statute, mean in s 10 in connection with the business and operations of a railway as a carrier of goods by rail.

In *Hammington v Ross* (1992) 2 NZ ConvC 191,150, the High Court considered whether a lawyer's omission to disclose his investment in the client's product to the client was a "civil liability incurred in connection with the provision of professional services". McGechan J stated, at page 191,162:

> One next goes to the operative clause. It provides cover for claims arising from civil liability incurred "in connection with" provision of "professional services". The clause is a broad one. It extends to "civil liability", not mere classical "neglect, error or omission". It extends to claims incurred *"in connection with"* the provision of professional services, as contrasted with "in the" provision of professional services. It is not limited to strict integral components of those very services themselves. With that wider wording it was conceded, and rightly, that activity covered would include omission to provide, and "ancillary conduct not strictly professional work – eg, the business advice here". Clearly however there must be a nexus between such wider activity giving rise to liability and the professional services. The wider activity must be related, and not merely co-existent.

In *Pan Pacific Forest Industries (NZ) Ltd v Norwich General* (1997) 7 TCLR 560, the High Court considered whether an insurance policy applied where the product supplied was faulty. The relevant policy applied to "accidental loss of…property…resulting from accidents in connection with the business". Paterson J stated at page 569:

> The operative provisions of the policy apply of the accident was "in connection with the business". Giving those words their natural and ordinary meaning the accident did arise in connection with the business if it arose because the business supplied faulty materials and parts and gave faulty advice.

The phrase "in connection with", has also been considered in the context of section DJ 5 of the Income Tax Act 1994, a provision that allows a tax deduction for costs incurred "in connection with" the determination of a liability to tax. In that context, Bathgate DJ found in *Case E84* that the term required a narrow interpretation. He said, at page 59,445:

> It may be that only an empirical and common sense approach to the interpretation of the words can be applied in each particular case to determine where, if at all, the line should be drawn to allow or not allow expenditure "in connection with" an assessment. However I believe that a narrow interpretation of the words "... any expenditure ... in connection with ... the assessment ..." is the correct interpretation: only expenditure closely and immediately connected to the assessment itself is intended to be allowed as a deduction, and expenditure more remote, as for instance in this case, the expenditure of O in making his trip to visit A, is not expenditure allowed as a deduction under the section.

This case suggests that, in the context of section DJ 5, the phrase "in connection with" requires a close linkage between the expenditure and the "determination" or "calculation" of a liability to tax.

The above cases suggest that for something to be "in connection with" something else, a relevant nexus is required, and that the two things must be related to each other in some way. Overall, the Commissioner considers that they suggest a broad interpretation should be given to the term.

The meaning of "in respect of or in relation to"

It is also necessary to consider the relevant words that were used in the Income Tax Act 1994. As noted, in that Act the relevant test was whether an amount was "in respect of or in relation to" employment, and thus "monetary remuneration".

The Court of Appeal endorsed a very wide meaning of the phrase "in respect of or in relation to". In *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11,303, where lump sum payments had been made by Shell to employees who transferred at the request of Shell, the Court discussed the relevant part of the definition of "monetary remuneration". McKay J, delivering the judgment of the Court, said at page 11,306:

> 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 employee 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".

Other New Zealand cases (*Case U38* (2000) 19 NZTC 9,361 and *CIR v Kerslake* (2001) 20 NZTC 17,158) have also considered the phrase "in respect of or in relation to". Both cases are consistent with the authorities cited above in this commentary.

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 for GST purposes. 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, which was later upheld by the Court of Appeal. In the High Court 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.

In *Cleland v CIR* (2001) 20 NZTC 17,086, the High Court considered the tax treatment of sums awarded to the taxpayer by the Employment Court for a personal grievance he brought against his employer. The Employment Court awarded a total amount of $126,000, comprising $46,000 for loss of wages, $50,000 for loss of benefits, and $30,000 for humiliation.

There was no issue regarding the amount paid for humiliation before Hammond J in the High Court, and accordingly he made no comment on this amount. He concluded that the amount paid for lost wages was therefore assessable as "monetary remuneration". In respect of the further amount of $50,000, Hammond J concluded that it was compensation for loss of office or employment. In order to reach this conclusion Hammond J had to consider whether the amount was "in respect of or in relation to" the taxpayer's employment or service.

Hammond J referred to the Court of Appeal decision in *Shell* and noted that those words are to be interpreted widely. Counsel for the taxpayer relied heavily on the Full Federal Court decision in *Rowe*. Hammond J stated at paragraphs 46 to 48 of his judgment:

> The award is clearly a "rolled up" one by the Employment Court in respect of or in relation to Mr Cleland's past employment.
>
> …
>
> As a sub-part of the argument, it was said for Mr Cleland that, because the award was calculated on future wages and benefits, it was not compensation for (past) loss of office or employment. That is not the test. The test is whether the wages and benefits actually awarded arose out of Mr Cleland's employment. It does not at all follow that, because the award was made relating to a period after the termination of the employment, it was not made in respect of, or in relation to, the employment. As Mr Almao said, "compensation for loss of office or employment by its very nature encompasses future benefits; benefits that an employee might have received had his or her employment continued".

Similarly, the meaning of the words "in connection with" can be affected by the context in which they are used. In this regard, the context in which the words "in connection with" are used is to provide that a benefit in money will be income of a person where it is derived "in connection with their employment or service". Therefore, as noted above the term "in connection with" has a wide meaning, but only, in this context, in respect of "employment or service".

Not all payments to employees are "in connection with" employment or service

However, there is authority to support the view that not all payments made by an employer to an employee are in connection with employment, or previously 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 page 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 *FC of T v Rowe* (1995) ATC 4,691 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.

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 of 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.

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.

J & G Knowles & Associates Pty Ltd v FC of T (2000) ATC 4,151 discusses the words "in respect of the employment" in the Australian FBT legislation. This 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*.

In the Commissioner's view, the term "in connection with", in the context of a payment being made "in connection with" a person's employment or service, is to be given a very broad interpretation and has a very wide operation. However, it is still necessary for there to be a sufficient relationship or nexus between the payment and the person's employment or service.

The nature and context of the payments

For an amount to be "in connection with employment" there must be a sufficient or material relationship between the payment and the employment.

Under section 92M of the HRA, damages may be awarded by the Tribunal for a breach of any of the provisions of Part 1A and Part 2 of that Act or where there has been a breach of the terms of a settlement of a complaint. As discussed above, breaches may not necessarily be in an employee/employer situation. If a claim is brought in the Tribunal which does not involve an employee/employer relationship it is clear that payment under section 92M(1)(c) cannot be described as monetary remuneration.

Where the complaint brought before the Tribunal does occur in the context of an employee/employer relationship, the connection of the employment relationship with payments under the HRA is tenuous. The HRA is not "employment legislation", although it may often operate in the employment context. Payments under section 92M(1)(c) of the HRA for humiliation, loss of dignity, and injury to feelings are **not** compensation for services rendered or for actions that occur in the normal course of the employment relationship. Rather the payments would be in the nature of reparation for a wrong done to the complainant and so would not be in respect of employment.

Payments of damages awards under section 92M(1)(c) of the HRA 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.

The Commissioner considers payments under section 92M(1)(c) of the HRA to be too remote from the employment relationship to be regarded as being an amount derived by a person "in connection with their employment or service". This is consistent with the view previously reached that such amounts are not within the definition of "monetary remuneration" under the Income Tax Act 1994. If a complaint is brought in the Tribunal which involves an employee and an employer, the employment relationship in such instances is merely part of the background facts against which the damages payments are made. The payments are not made "in connection with their employment or service".

Income under ordinary concepts

Payments for damages made under section 92M(1)(c) of the HRA are not "income under ordinary concepts" under section CA 1(2).

Although the legislation does not define "income under ordinary concepts", a great number of cases have 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 (*Scott v C of T* (1935) 35 SR (NSW) 21 and *Reid v CIR* (1985) 7 NZTC 5,176). It is clear that payments under section 92M(1)(c) will not generally be made periodically or regularly, or generally recur. Nor as we have seen above, are they compensation for services.

Capital receipts do not form part of a person's income unless there is a specific legislative provision to the contrary. And by analogy with common law damages, damages payments under section 92M(1)(c) of the HRA are of a capital nature as Barber DJ acknowledged 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

The Commission endeavours to settle disputes between parties and sometimes, the parties negotiate a settlement before the dispute is referred to the Tribunal. The settlement agreement may state that the payment is for humiliation, loss of dignity, or injury to feelings. In return for the complainant or aggrieved person surrendering his or her rights under the HRA, the other party 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 Tribunal. A payment can be for humiliation, loss of dignity, or injury to the feelings of the complainant or aggrieved person whether the Tribunal is 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 settled by the Human Rights Commissioner under the HRA. The onus of proof regarding the taxability of any such payment would be on the taxpayer.