

1 February 2023

Hon David Parker
Minister of Revenue

By email: d.parker@ministers.govt.nz

Tēnā koe Minister Parker

Re: The tax treatment of backdated ACC payments and unfair impacts on ACC claimants

1. I am writing to you as President of the New Zealand Law Society | Te Kāhui Ture o Aotearoa, regarding the tax treatment of backdated ACC payments, and the unfair impacts of this treatment on ACC claimants.
2. There is currently no statutory framework which specifically addresses the tax treatment of backdated ACC entitlement payments. Section BD 3 of the Income Tax Act 2007 (**Act**) simply provides that an amount of income should be allocated to the income year in which that amount is ‘derived’, unless other provisions of the Act provide for allocation on another basis.¹
3. For the purposes of determining the time at which an amount of income is ‘derived’, the Act states:²
 - When the time of derivation of an amount of income is being determined, regard must be had to case law, which—
 - (a) requires some people to recognise income on an accrual basis; and
 - (b) requires other people to recognise income on a cash basis; and
 - (c) more generally, defines the concept of derivation.
4. In the absence of any further statutory guidance, the courts have determined that backdated lump sum payments should be taxed on a ‘cash basis’.³ This means the lump sum is taxed based on the tax rates for the year in which the payment is *received* by the person, rather than the year in which the right to receive the payment arose.
5. In reality, this means backdated ACC payments are often taxed at higher rates, particularly where the payments are made several years after the time the entitlement arose, and tax rates have increased (some significantly) in that time. ACC claimants who receive backdated payments after lengthy periods are then exposed to a higher rate of tax than they would have if ACC had paid their entitlements at the time they were originally due.⁴ As a result, this

¹ Section BD 3(2).

² Section BD 3(3).

³ Commissioner of Inland Revenue v The National Bank of New Zealand (1976) 2 NZTC 61,150.

⁴ In *Case K23* (1988) 10 NZTC 233, there was evidence before the Tax Review Authority that, as a result of receiving the compensation in one lump sum payment, the appellant’s tax liability was twice as much as it would have been, had the compensation been paid in instalments as the right to it accrued.

cohort of ACC claimants are required to pay higher taxes, and receive a smaller sum of entitlement payments because of ACC's failure to pay the entitlements at the time they arose, and through no fault of their own.

6. Some ACC claimants have sought to address this unfair treatment by appealing decisions regarding the tax treatment of backdated payments to the Tax Review Authority (**Authority**) and the High Court.⁵ These claimants have argued that:
 - a. Backdated ACC payments should be taxed on an 'accrual basis' (where the income is derived in the income year in which the income is 'earned'); and
 - b. The Commissioner of Inland Revenue (**Commissioner**) has a discretion to apply the lower tax rates that would have applied if the backdated payments were allocated to the tax years over which the ACC entitlements accrued.
7. However, the Authority and the Court have concluded it is "settled law"⁶ that the taxpayer derives the income when it is received, and it cannot be attributed to earlier years to which the calculation of the income relates.⁷
8. However, the Authority and the courts have frequently acknowledged the unfair impacts this has on claimants, and have signalled that a legislative fix is needed to address the inequities within the current framework. In *Case N9*, Barber DJ stated:⁸

In these situations of the checks and balances of the accident compensation system often leading to earnings-related compensation being paid in a later financial year than that to which it relates, one can understand the references of [the appellant] to a lack of commonsense and justice where the delay increases the tax rate on the compensation. ... Maybe, it needs to be addressed by legislation...
9. Most recently, Campbell J noted, in *Hoeberechts v Commissioner of Inland Revenue*:⁹

I have considerable sympathy for the position in which Ms Hoeberechts has been placed by ACC's late payment of her entitlements. She has been exposed to a higher rate of tax than she would have incurred had ACC paid her entitlements on time. Ms Hoeberechts put before me material that shows that there are a significant number of people that have been similarly affected by the tax treatment of backdated ACC payments. But I have no doubt that that treatment is in accordance with the Income Tax Act. Any change in that treatment is a matter for Parliament. Neither the Commissioner, the Authority nor this Court has power to effect any such change.
10. ACC claimants who have been treated unfairly as a result of the current law are therefore left in a state of limbo, without any recourse to address the unfair, and likely unintended, impacts of the law.

⁵ See, for example, *Hollis v Commissioner of Inland Revenue* (2010) 24 NZTC 23,967; *X v Commissioner of Inland Revenue* [2021] NZTRA 3; and *Hoeberechts v Commissioner of Inland Revenue* [2022] NZHC 2200.

⁶ This "settled law" stems from cases previously considered by the Authority (including, for example, *Case H24* (1986) 8 NZTC 246, *Case H46* (1986) 8 NZTC 377, *Case H70* (1986) 8 NZTC 496, *Case J46* (1987) 9 NZTC 1,262, and *Case N9* (1991) 13 NZTC 3,075).

⁷ *Hollis v Commissioner of Inland Revenue*, above n 5.

⁸ *Case N9* (1991) 13 NZTC 3,075 at 3,080.

⁹ *Hoeberechts v Commissioner of Inland Revenue*, above n 5, at [49].

11. We therefore invite you to consider amending the Act to clarify that backdated lump sum payments should be taxed on an accrual basis, rather than on a cash basis. Such an amendment would address the unfair treatment of ACC claimants who are adversely impacted by changes to the income tax rates, through no fault of their own. Given this requires a change to the current tax policy settings, we consider it is more appropriate for Parliament, rather than the courts, to weigh up any relevant and/or competing policy considerations and determine the most suitable basis for taxing backdated lump sum payments from ACC.
12. If the Government determines it is in fact appropriate to tax backdated lump sum payments on a cash basis, this should be supported by a clear policy rationale, and explicitly set out in the Act.¹⁰
13. Please do not hesitate to contact me via the Law Society's Law Reform & Advocacy Advisor, Nilu Ariyaratne (Nilu.Ariyaratne@lawsociety.org.nz), if you have any questions, or if you would like to discuss this further.

Nāku iti noa, nā



Frazer Barton
President

Cc: Hon Peeni Henare, Minister for ACC (p.henare@ministers.govt.nz)

¹⁰ We appreciate that the courts may have concluded that backdated lump sum payment should be taxed on a cash basis to ensure the recipients do not become liable for late payment penalties and use of money interest (see *X v Commissioner of Inland Revenue*, above n 5, at [27]). However, these issues could also be easily addressed as part of a legislative fix relating to backdated payments.