IN THE DISTRICT COURT
AT WELLINGTON

I TE KŌTI-Ā-ROHE
KI TE WHANGANUI-A-TARA

[2024] NZACC 19 **ACR 112/22**

UNDER	THE ACCIDENT COMPENSATION ACT 2001
IN THE MATTER OF	AN APPEAL UNDER SECTION 149 OF THE ACT
BETWEEN	MICHAEL WATSON Appellant
AND	ACCIDENT COMPENSATION CORPORATION Respondent

Hearing:	9 May 2023
Heard at:	Auckland
Appearances:	B Hinchcliff for Appellant I Hunt for Respondent
Judgment:	8 February 2024

RESERVED JUDGMENT OF JUDGE I C CARTER
[Weekly Compensation / shareholder-employee / s 15, Schedule 1 clauses 31, 39, 41, 42]

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Introduction

[1] Mr Watson's appeal challenges the correctness of the:

(a) Corporation's decision dated 19 January 2022 ("the Corporation's Decision), declining Mr Watson's request for weekly compensation arising from his ankle injury on 18 July 2021.

(b) Subsequent decision dated 4 July 2022 ("the Review Decision") declining Mr Watson's application for review and confirming the Corporation's Decision.

[2] The appeal is by way of re-hearing and a general appeal, which means that the District Court is required to undertake its own evaluation of the evidence and merits generally.[1] The Review Decision is considered, but the Court may come to a different conclusion.[2]

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[1] *Accident Compensation Corporation v Bartels* [2006] NZAR 680 at [65]; *Atapattu-Weerasinghe v Accident Compensation Corporation* [2017] NZHC 142 at [23]; *BL v Accident Compensation Corporation* [2023] NZACC 106.

[2] *Wildbore v Accident Compensation Corporation* [2009] NZCA 34, [2009] 3 NZLR 21 at [29].

[3] In this particular case, the key challenges on appeal are to two separate exercises of discretion by the Corporation under clause 31, Schedule 1, and s 15(1)(b) of the Accident Compensation Act 2001 ("the Act").[3] The grounds for challenging those determinations by the Corporation are confined to whether the relevant statutory discretion was exercised in a way that involved an error of law or principle, taking account of irrelevant considerations, failing to take account of a relevant consideration or the decision was plainly wrong.[4]

Issues

[4] At issue is whether the Corporation was correct in determining that Mr Watson had nil earnings as a shareholder-employee for the year ending 31 March 2021 for the purpose of calculating his base weekly compensation figure, or whether the Corporation should not have taken into account Mr Watson's relevant income tax return and financial statements and instead calculated an amount which represented "reasonable remuneration" for the relevant tax year under s 15(3) of the Act.

[5] Clause 31 of Schedule 1 and s 15 of the Act have a significant bearing in determining these issues.

[6] The application (or not) of clauses 39, 41 and 42 of Schedule 1 is also relevant.

Facts

[7] The relevant facts are not substantially in dispute.

[8] At all material times, Mr Watson was a shareholder-employee of L & M Developments (2009) Limited (L & M) as a painter/decorator. Mr Watson, together with Ms Leah Watson, were directors of L & M. Mr Watson, Ms Watson and the Watson Management Trust are the shareholders of L & M.

[9] On 5 February 2020, Mr Watson suffered an ankle injury (the 2020 claim). From 17 February 2020 until 19 April 2021 Mr Watson received weekly compensation entitlements.

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[3] Clause 31(b) "…if- …the Corporation considers that" the income tax return and related accounts have not been unreasonably influenced by the claimant's incapacity; Section 15(1)(b) "… if the Corporation decides that" the shareholder-employee's income declared in the relevant income tax return is not a reasonable representation of earnings.

[4] *Kacem v Bashir* [2010] NZSC 112, [2011] 2 NZLR 1, [2010] NZFLR 884, (2010) 28 FRNZ 483 at [31], [32], [33].

[10] From 19 April 2021 until July 2021, Mr Watson returned to work for L & M.

[11] On 18 July 2021, Mr Watson sustained another ankle injury. A claim was lodged and the Corporation accepted cover to Mr Watson for an ankle sprain (the 2021 claim). Medical certificates were provided by Mr Watson's GP certifying that he was unfit to work between 27 August to 10 September 2021, 11 September to 24 October 2021, and 25 October to 19 December 2021. Mr Watson's incapacity commenced on 27 August 2021.

[12] Mr Watson was working an average of 41.25 hours in the four weeks prior to incapacity in L & M (as a shareholder-employee) at the time of his accident.

[13] Mr Watson's earnings to 31 March 2021, as shown in the Corporation's claim management system EOS, were as follows:

Period ending 31 March	2021	2020	2019	2018	2017
Shareholder- employee (no deductions) salary	-	-	-	-	-
Self-employed income	-	-	8,236	-	-
Salary and wages (ACC Weekly Compensation)	29,961	-	-	6,107	1,909
Total	**29,961**	-	8,236	6,107	1,909

[14] The Corporation was provided with financial statements for L & M for the years ended 31 March 2018 to 31 March 2021, together with a special purpose financial statement for the six months ending September 2021. L & M financial statements showed that it paid contractors $95,009.00 during the relevant year and none or little in other years. For the six months ending 30 September 2021 had $227,991.26 in sales and $188,169.78 in expenses.

[15] IRD records showed that:

(a) From 17 February 2020 to 19 April 2021, Mr Watson was receiving weekly compensation;

(b) Between 1 April 2021 and 31 May 2021, L & M had no earnings, but incurred $7,105.35 (excluding GST) in expenses;

(c) Between 1 August 2021 and 30 September 2021, L & M had $7,024.36 in sales and income, and $18,858.43 (excluding GST) in expenses.

[16] The Trading Account for the six months ending 30 September 2021 showed that L & M had a gross trading surplus of $2,860.62.

[17] On 18 January 2022, Erica Roets (Technical Accounting Specialist Adviser with the Corporation) provided a memorandum in relation to Mr Watson's weekly compensation entitlements. Her analysis of the financial information provided to the Corporation and IRD records and application of the relevant provisions of the Act was:

(a) At the time of Mr Watson's accident and incapacity, he was an "earner" as defined in s 6.

(b) The Corporation will accept that a recent or established non-PAYE shareholder-employee has earnings immediately before the start of the incapacity if, in the most recent income year:

[i] They received earnings as a shareholder-employee, and evidence of earnings in the relevant year indicates that there are likely to be earnings immediately before the start of the incapacity;

[ii] There are no earnings, but there is evidence of a recent significant change in the company, and because of the change, a salary would reasonably have been expected in the income year in which the incapacity arose.

(c) There was no evidence of a shareholder salary immediately prior to incapacity, and therefore there is no loss of earnings to Mr Watson under clause 32, Schedule 1 of the Act.

(d) There was no evidence of a recent significant change in the company, and therefore no salary would reasonably have been expected in the 2022 income year in which the incapacity arose.

(e) Mr Watson did not receive earnings as a shareholder-employee in the relevant year, and the special purpose financial statements confirmed that the company traded at a loss during the year of incapacity.

(f) In previous years:

[i] The evident accounting policy was that when the company traded at a loss, a shareholder salary was not paid.

[ii] Allocation of nil shareholder salaries was to minimise tax by using prior year trading losses to reduce profits to nil.

[iii] The market value of Mr Watson's services was not a consideration in attributing shareholder salaries prior to his incapacity and should not be a factor in determining his remuneration.

(g) Clause 42 applies to weekly earnings of earners in full time employment to lift the fulltime minimum rate when the claimant works 30 hours or more per week in the four weeks leading up to the incapacity.

(h) Clause 39 required Mr Watson to have shareholder employee earnings in the relevant year, and if the earnings are nil in the relevant year, then there should be solid evidence to show that there could be earnings at the time of the incapacity.

(i) As there were no shareholder employee earnings immediately before Mr Watson's date of incapacity, clause 39 does not operate.

(j) Clause 42 can apply only if clause 39 applies. Consequently, clause 42, which lifts earnings to the full-time minimum rate, does not apply.

(k) In the circumstances, the Corporation did not consider that Mr Watson had shareholder earnings at the time of incapacity. Mr Watson accordingly was not entitled to weekly compensation.

[18] Ms Roets also reviewed the financial statements, which showed that:

(a) L & M's sales income increased from $63,885 in year end 2020 to $227,991 in 2021.

(b) L & M traded at a loss in years 2018 to 2020.

(c) A tax minimisation policy was applied in 2021 and the whole profit of $26,311 was offset against losses brought forward from previous years.

(d) Based on the special purpose financial statements, the company was trading at a loss.

[19] Ms Roets ultimately concluded that Mr Watson was not entitled to weekly compensation.

[20] The Corporation's Decision dated 19 January 2022 declined Mr Watson's claim for weekly compensation.

[21] Mr Watson applied for review and his application was heard on 26 May 2022. The key arguments advanced on Mr Watson's behalf were:

(a) Mr Watson was an earner, and a shareholder-employee at the time of his accident and incapacity.

(b) Mr Watson received weekly compensation earnings in the relevant year (ending March 2021).

(c) The income he received as a shareholder-employee was not a reasonable representation of his earnings in the relevant year.

(d) Given that position, the Corporation should have applied s 15(3) to determine an amount that represents reasonable remuneration for services provided as an employee to the company.

[22] Mr Watson filed an affidavit stating that from 20 April to 18 July 2021 he worked for the company L & M as a shareholder-employee, working at least 40 hours per week, and that a reasonable income for someone working as a director of the company would be at least $100,000.00 per year.

[23] After the review hearing, counsel for Mr Watson filed a supplementary submission elaborating that:

(a) The legislation does not state that the Corporation can only put aside a tax return if it was unduly influenced by the claimant's incapacity - this is an internal Corporation policy.

(b) Mr Watson's position is that s 15(3) should be used in all weekly compensation calculations when applying clause 39.

(c) If s 15(3) had been used, Mr Watson's reasonable earnings would have been at least $100,000 per year, and this figure should be used to calculate Mr Watson's weekly compensation entitlement.

[24] On 4 July 2022, Mr Watson's application for review was dismissed. The Reviewer, Ms Perkin, held that as there was no evidence of shareholder salary prior to incapacity, there was no loss of earnings under clause 32 for which the Corporation would be liable to pay weekly compensation.

[25] The Reviewer also held that the Corporation is not required to undertake an assessment under s 15(3), as the s 15(2) analysis provided a reasonable representation of Mr Watson's earnings as a shareholder-employee.

Appellant's submissions

[26] Mr Hinchcliff submitted that Mr Watson is entitled to weekly compensation, as s 15(3) and clauses 39, 41 and 42 of Schedule 1 apply.

[27] Section 6 states "earnings as a shareholder-employee has the meaning set out in section 15."

[28] Section 15(1)(b) applies because Mr Watson's shareholder-employee income "is not a reasonable representation of the person's earnings as a shareholder-employee in the tax year."

[29] Consequently, citing *Hamilton v Accident Compensation Corporation*,[5] a reasonable representation of earnings is to be determined by the Corporation under s 15(3) that represents reasonable remuneration for the services that Mr Watson provided to the company as an employee of the company in the tax year.

[30] The Corporation must apply s 15(3) providing for reasonable remuneration for the services Mr Watson performed for his company.

[31] An income tax return does not need to be rejected, under clause 31 of Schedule 1, before the Corporation can decide that the earnings were not a reasonable representation of the person's earnings.

[32] Mr Watson had earnings in the 52 weeks prior to incapacity in the form of weekly compensation paid from 17 February 2020 until 19 April 2021. Under clause 39(2)(c), weekly compensation payments are calculated based on the claimant's earnings as a shareholder-employee in the relevant year, divided by the number of weeks in the relevant year.

[33] The Corporation did not consider the earlier weekly compensation payments. Those were earnings that created unreasonable earnings for Mr Watson.

[34] The Corporation did not calculate what reasonable remuneration would be for someone working in Mr Watson's role at L & M. His affidavit evidence is that reasonable earnings

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[5] *Hamilton v Accident Compensation Corporation* [2019] NZHC 3109.

would be $100,000.00 per year. Weekly compensation calculations should use that amount as earnings.

[35] Clause 39 applies because Mr Watson had relevant earnings.

[36] Clause 41 applies because Mr Watson had earnings as an employee.

[37] If estimated earnings under s 15 do not apply, clause 42 of Schedule 1 applies and the weekly compensation should be adjusted to the statutory minimum.

Respondent's submissions

[38] The Corporation submits that because Mr Watson had no earnings as a shareholder-employee during the relevant year, he is not entitled to weekly compensation.

[39] The default position is that the Corporation must take into account Mr Watson's relevant income tax return and related accounts, which showed nil shareholder-employee earnings.

[40] There was no basis for departing from that default position because there was nothing to suggest that the relevant tax return and related accounts were unreasonably influenced by his incapacity or the effects of incapacity on Mr Watson's income or business activities (clause 31(b)).

[41] The Corporation was correct to accept and give weight to the relevant tax return.

[42] The Corporation made no error of law or principle when accepting under s 15(1)(b) and s 15(2) Mr Watson's nil return of income was a reasonable representation of his shareholder employee income and there was therefore no basis for making a determination under s 15(3) of reasonable remuneration.

[43] *Hamilton's* case does not apply to Mr Watson's circumstances.

[44] Clause 39 does not apply because Mr Watson had no earnings as a shareholder-employee immediately before his incapacity commenced.

[45] Clause 41 does not apply in this case because Mr Watson had no earnings as an employee at the time his incapacity commenced on 27 August 2021.

[46] Clause 42 (containing a mechanism to lift earnings to a minimum statutory rate) does not apply because it is engaged only if clause 39 applies. Clause 39 does not apply because Mr Watson had no earnings as a shareholder-employee immediately before his incapacity commenced.

Law

[47] Clause 32 of Schedule 1 of the Act directs the Corporation to pay weekly compensation for loss of earnings to a claimant who has an incapacity resulting from a personal injury for which he or she has cover; and was an earner immediately before his or her incapacity commenced.

[48] Clause 39 of Schedule 1 sets out how the Corporation is to calculate weekly compensation for a claimant who had earnings as a shareholder-employee immediately before the claimant's incapacity commenced.

[49] Sub-clause (1) requires a claimant to have had earnings as a shareholder employee immediately before incapacity commenced for entitlement to weekly compensation to apply. If this condition is met, sub-clause (1) allows the higher rate to be paid of the earnings calculated under clause 34 or 36 (in cases where PAYE earnings were received) or earnings calculated using relevant year earnings in one of the formulae in sub-clause (2).

[50] Different methods of calculating weekly earning in various different situations are set out in clause 39. They apply to the claimant's relevant tax year. Clause 30(2) of Schedule 1 defines the "relevant year" of a shareholder-employee as the most recent year ending with the balance date of the shareholder-employee before the commencement of the period of incapacity.

[51] "Earnings as an employee" is defined in s 9 of the Act as all PAYE payments received by the claimant for the relevant tax year. Because weekly compensation payments made by the Corporation have PAYE deducted at the source, they are generally treated as earnings as an employee under the Act.

[52] Section 15 of the Act defines earnings as a shareholder-employee as:

> **15 Earnings as a shareholder-employee**
>
> (1) Earnings as a shareholder-employee, in relation to a person who is a shareholder-employee and any tax year, means-
>
> (a) the amount described in subsection (2) (the subsection amount); or
>
> (b) the amount described in subsection (3) (the subsection amount), if the Corporation decides that the subsection (2) amount is not a reasonable representation of the person's earnings as a shareholder-employee in the tax year.
>
> (2) The subsection (2) amount is-
>
> (a) all PAYE income payments of the person for the tax year derived from a company of which the person is a shareholder-employee; and
>
> (b) all income of the person that is deemed to be income derived otherwise than from PAYE income payments under section RD 3B or RD 3C of the Income Tax Act 2007.
>
> (3) The subsection (3) amount is an amount determined by the Corporation in the following way:
>
> (a) first, determine each of the following amounts:
>
> (i) an amount that represents reasonable remuneration for the services that the person provides to the company as an employee of the company in the tax year; and
>
> (ii) an amount that represents reasonable remuneration for the services that the person provides as a director of the company in the tax year; and
>
> (b) second, add the amounts described in paragraph (a)(i) and (ii), and the result is the subsection (3) amount.
>
> (4) The earnings as an employee of the person as an employee of the company are the amount described in subsection (3)(a)(i).

[53] Clause 31 of Schedule 1 requires the Corporation to take into account a claimant's income tax return for the "relevant year" and provides:

> **31 Use of income tax returns in determining earnings**
>
> If the Corporation is determining earnings under this Part in relation to a self-employed person or a shareholder-employee, it must take an income tax return into account, if-
>
> (a) the claimant has given the return to the Commissioner; and

(b) the Corporation considers that the return, and any related accounts, have not been unreasonably influenced by-

(i) the fact of the claimant's incapacity; or

(ii) the effects or likely effects of the incapacity on the claimant's income or business activities.

[54] The Corporation's initial default position under the Act is for the calculation of weekly earnings for a shareholder-employee (and for a self-employed person) by reference to the claimant's income tax return.[6] The High Court in *Simpson v Accident Compensation Corporation* recently confirmed that the default position is PAYE income payments evident from the relevant tax return:[7]

> [33] In short, the s 15(2) method is the default. It applies unless the Corporation decides that the amount produced by that method is not a reasonable representation of the claimant's earnings, in which case the method in s 15(3) applies. The choice of method for determining "earnings as a shareholder-employee" therefore depends on whether the Corporation makes such a decision.

[55] As Judge Barber said at [42] in *Pratley v Accident Compensation Corporation*:[8]

> [42] Cleary, the intent in the Act is to compensate for lost earnings (on which tax and levies have been paid). The appellant cannot arrange his affairs to avoid such liabilities but still expect to receive the benefit of compensation in the event that he has an incapacity.
>
> [43] It was argued for the appellant that, at material times, he was an earner (and I accept that he was within that definition set out above) but that his earnings were "zero". I consider that he had no earnings so there is nothing to be compensated for by ACC. If a person structures his (or her) affairs to result in there being no income earned by that person at material times, then entitlement to earnings-related compensation is lost. Also, there could be avoidance of income tax ...

In the same decision, Judge Barber concluded, that:[9]

> [47] Earnings received prior to the current period of incapacity are relevant to determine entitlements under the Act. As a shareholder-employee prior to that incapacity, the appellant had structured his activities so as to have no earnings. Therefore, he has no entitlement to weekly compensation for his current incapacity.

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[6] *Nicholas v Accident Compensation Corporation* [2008] NZACC 110 at [24] - [26].
[7] *Simpson v Accident Compensation Corporation* [2023] NZHC 1661 at [33].
[8] *Pratley v Accident Compensation Corporation* [2010] NZACC 42 at [42]. (Decision 42/2010, AI 107/09, Dunedin, 8 March 2010).
[9] Above n 8 at [47].

[56] The statutory initial default position stems from the clause 31 requirement that the Corporation "must take an income tax return into account" if the return is filed with IRD and the Corporation does not consider that the return was "unreasonably influenced" by the fact of the claimant's incapacity or its effects, or likely effects.

[57] The phrases "take into account" and "have regard to" are commonly used in legislation and are treated as synonymous.[10] A statutory requirement for a decision maker to "take into account" or "have regard to" something means simply that the decision-maker, when making a decision, must consider that thing and any specific criteria in the relevant statutory provision. All that is necessary is for the decision maker to have an open and receptive mind and to turn his/her mind to the thing and any relevant statutory criteria.[11]

[58] But what, if any, weight the decision-maker gives to a particular criterion in the particular case is for the decision-maker to decide. This means that failing to take into account a relevant consideration is an error of law, but failing to have "sufficient regard to" or "properly take into account" relevant factors is not.[12] A decision-maker may properly conclude that a mandatory relevant consideration is not of sufficient significance to outweigh other considerations, which it must also take into account.

[59] In applying clause 31 then, the Corporation, when calculating shareholder-employee earnings, must take into account a relevant income tax return and it is for the Corporation to decide whether to give it full weight or lesser weight if it is outweighed by other relevant considerations.

[60] Clause 31 specifically prescribes the one circumstance when the Corporation may give a tax return *no weight* at all and is expressly authorised to *not* take it into account. If the particular statutory criterion in clause 31(b) – where the Corporation considers that the return and any related accounts were unreasonably influenced by a claimant's

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[10] *New Zealand Transport Agency v Architectural Centre Inc* [2015] NZHC 1991, [2015] NZRMA 375 at [63].

[11] *New Zealand Fishing Industry Association v Minister of Agriculture and Fisheries* [1988] 1 NZLR 544, 552, 566; *New Zealand Co-operative Dairy Company Limited v Commerce Commission* [1992] 1 NZLR 601 (HC) at [612] to [613], [1991] NZAR 433; *Greenpeace New Zealand Inc v Minister of Fisheries* HC Wellington CP492/93, 27 November 1995 at [25] to [26]; *Te Runanga O Raukawa Inc v Treaty of Waitangi Fisheries Commission* CA178/97, 14 October 1997 at [8]; *Singh v Chief Executive, Ministry of Business, Innovation and Employment* [2015] NZCA 592, [2016] NZAR 93 at [17], [43] to [46]; *Ishak v Thowfeek* [1968] 1 WLR 1718, (P.C.).

[12] *Haldane Ltd v Disputes Tribunal* [2017] NZHC 1526 at [27].

incapacity/effects/likely effects – the Corporation is not required to take the income tax return into account at all and may disregard it or give it no weight.

[61] In specified situations, the Corporation may consider multiple categories of earnings, such as a claimant's earnings as shareholder-employee and earnings as an employee (including weekly compensation). Clause 41 of Schedule 1 then applies specified formulae to calculate the amount of weekly compensation in different circumstances for the purpose of ensuring that claimants receive as fair a weekly compensation as possible. However, for clause 41 to apply, a shareholder-employee must have had earnings as an employee at the time their incapacity commenced.[13] Mr Watson had no earnings as an employee as at the commencement of the period of incapacity from 27 August 2021. Clause 41 does not therefore apply to him.

"Unreasonably influenced" under clause 31(b)

[62] The concept of "unreasonably influenced" in clause 31(1)(b) was considered in *Accident Compensation Corporation v Davis*[14] in which Judge Beattie held:

> [22] The relevant words in clause 31 involve the consideration of whether or not the tax return has been <u>unreasonably influenced</u> by the fact of the claimant's incapacity. Those words clearly indicate that if there is evidence that the tax return has been "doctored" to enable an unsupportable income to be the basis of an assessment of weekly compensation, that income will not be accepted as being valid for weekly compensation purposes.
>
> [23] A classic example of this would be if a claimant had received modest advances over the financial year to meet day-to-day needs and then subsequent to an incapacity financial accounts and a tax return is lodged which identifies a sum wholly out of kilter with the company's financial ability to pay, and out of step with what might be considered reasonable remuneration for the level of work carried out. I also consider that evidence of any significant change from previous years would also be a relevant factor.
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> (emphasis in original)

Interrelationship between section 15 and clause 31

[63] The interrelationship between section 15 and clause 31 was considered by Judge Maclean in *Irwin v Accident Compensation Corporation*[15] in the context of assessing

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[13] Clause 41(1) and (3), clause 39(1) Schedule 1.
[14] *Accident Compensation Corporation v Davis* [2011] NZACC 134 at [22], [23].
[15] *Irwin v Accident Compensation Corporation* [2016] NZACC 58

the appellant's post-injury earnings for the purpose of an abatement assessment. In that case, the appellant had continued to receive shareholder-employee earnings after his injury, which the Corporation was required to take into account by way of abatement in calculating his weekly compensation entitlement. The Corporation considered that the appellant's earnings as disclosed in his tax return had been "unreasonably influenced" by his incapacity (by understating his actual level of earnings) and had sought to assess his "reasonable remuneration" under section 15(3) of the Act.

[64] On appeal, Judge Maclean held that there was insufficient evidence to establish that the return was "unreasonably influenced", in the sense of a deliberate manipulation of the sort that the Court is sometimes considering in relation to allegedly inflated pre-accident earnings, to enhance post-accident compensation, as opposed to the situation which arose in that appeal where the Corporation believed that the appellant had deflated his post-accident earnings.

[65] In the context of that factual situation, Judge Maclean held that all that clause 31 required the Corporation to do was to take the tax return "into account" but that it was not bound by what was in the return and that it was entitled to apply section 15(3) to determine what would be a "reasonable remuneration". This is entirely consistent with the discussion above of the legal meaning of "take into account".

[66] In many cases where the Corporation is authorised to not take account of a relevant tax return and disregards it, the Corporation may go on to determine "reasonable remuneration" under s 15(3). However it must be kept in mind that the two provisions operate in parallel and involve different tests. Clause 31 is concerned with whether a relevant tax return and related accounts have been unreasonably influenced by incapacity or its effects or likely effects. Section 15(1)(b) triggers the operation of s 15(3) only if the Corporation decides that PAYE income payments and other deemed income derived in a relevant tax year is not a reasonable representation of a shareholder-employee's earnings. As Campbell J observed in *Simpson v Accident Compensation Corporation*, clause 31 and s 15 require similar decisions to be made by the Corporation, but turn on different considerations.[16]

[16] *Simpson v Accident Compensation Corporation* [2023] NZHC 1661 at [33], [34].

[67] In *Gardner v Accident Compensation Corporation*[17] Judge Walker accepted that:

> [163] …
>
> (7) Clause 31 directs ACC to take an income tax return that has been lodged with the IRD into account provided the return and any other related accounts have not been "unreasonably influenced" by the claimant's incapacity. When it is considered an income tax return or any related accounts have been unreasonably influenced by incapacity then they may be rejected under clause 31 and reasonable earnings determined under section 15(3).
>
> (8) Section 15(3) of the Act allows ACC to determine an amount that represents reasonable remuneration in relation to a person who is a shareholder-employee by
>
> (i) determining an amount that represents reasonable remuneration for the services that the person provides to the company as an employee
>
> (ii) determining an amount that represents reasonable remuneration for the services that the person provided as a director of the company
>
> (iii) The excess, being a dividend to the shareholder of the company, is not earnings of the person.

Corporation's statutory discretion to adopt reasonable representation of shareholder-employee's earnings under s 15(1)(b)

[68] The words in s 15(1)(b) "if the Corporation decides ..." clearly indicate a discretionary power of the Corporation to decide that "the subsection (2) amount is not a reasonable representation" of a shareholder-employee's earnings. The words in clause 31(b) "…if- …the Corporation considers that" also indicate a discretionary power of the Corporation to decide whether the relevant tax return and related accounts have not been unreasonably influenced by the claimant's incapacity. It is not in dispute that both clause 31(b) and s 15(1)(b) confer a discretionary power.

[69] It is well established that, where the Corporation exercises a discretion under the Act, it must do so properly and consistently with the Act. The grounds on which the exercise of such a discretion can be legally challenged on appeal are confined to it is established that the Corporation has:

(a) Made an error of law;

(b) Failed to take account some relevant matter;

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[17] *Gardner v Accident Compensation Corporation* [2016] NZACC 320 at [163].

(c) Taken into account an irrelevant matter;

(d) Made a decision which is plainly wrong.[18]

[70] A recent example of this in practice in a shareholder-employee case is *Brown v Accident Compensation Corporation*[19] where Judge Spiller confirmed that the Corporation's decision whether to undertake a section 15(3) assessment involves an exercise of discretion:

> [48] ... The Court acknowledges that section 15(3) allows the Corporation to calculate earnings as a shareholder-employee on a "reasonable remuneration" basis if the Corporation decides that the relevant income tax return amount is not a reasonable representation of the person's earnings as a shareholder-employee in the tax year. However, the Corporation's decision in this regard is a discretionary one, and this Court is not satisfied that, in exercising its discretion not to calculate earnings under section 15(3) the Corporation made an error of law, failed to take into account some relevant matter, or that its decision was plainly wrong ...

(emphasis added)

Analysis

[71] For the purposes of clause 30(2), there is no dispute that Mr Watson's balance date as shareholder-employee was 31 March. Mr Watson's relevant period of incapacity commenced from 27 August 2021. The "relevant year" in Mr Watson's circumstances was the year ended 31 March 2021, being the most recent year ending with his last balance date before the commencement of his period of incapacity from 27 August 2021. The relevant tax year for the purposes of calculating Mr Watson's basic weekly compensation as a shareholder-employee was the year ending on 31 March 2021.[20]

[72] The information available from the IRD in relation to Mr Watson's taxable income shows that he did not receive any earnings as a shareholder employee for the year ending 31 March 2021.

[73] Clause 31 requires the Corporation to take into account an income tax return if such has been given to the Commissioner and if the Corporation considers that the return and any related accounts have not been unreasonably influenced by the fact/effects/likely effects of the

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[18] *Kacem v Bashir* [2010] NZSC 112, [2011] 2 NZLR 1, [2010] NZFLR 884, (2010) 28 FRNZ 483 at [31], [32], [33].
[19] *Brown v Accident Compensation Corporation* [2023] NZACC 56 at [48].
[20] Clause 30(2).

claimant's incapacity on the claimant's income or business activities. That is, when determining earnings relevant to the calculation of weekly compensation of a shareholder employee, the Corporation is to look at income declared in a tax return and on which tax has been paid, unless it considers that the return has been unreasonably influenced by one of the factors specified in clause 31((b). It is only where the amount returned is unreasonably influenced by one of those specified factors in the sense of being "in some way loaded", "doctored", or "deliberately manipulated"[21] that the Corporation may not take into account the relevant income tax return and any related accounts.

[74] In the event that the relevant tax return is properly not taken into account, or the return is taken into account but given little weight, the Corporation must still somehow determine earnings as a shareholder employee for the purposes of calculating weekly compensation. Section 15 then comes into play and directs the Corporation how that calculation is to be done.

[75] The default earnings as a shareholder-employee as declared by s 15(1)(a) is the subsection (2) amount defined by s 15(2). This amount is comprised of all derived PAYE income payments plus certain other deemed income derived from the shareholder-employee's company.

[76] But the Corporation may decide under s 15(1)(b) that the default subsection 2 amount is not a reasonable representation of the shareholder employee's earnings for the relevant tax year. If so, the Corporation may then determine under s 15(3) the amount that represents "reasonable remuneration" for the services provided by the claimant to the company as an employee and as a director. The Corporation may then disregard the tax return and related accounts and instead determine an amount that represents "reasonable remuneration" for the services that the claimant provided to the company in the relevant tax year, under s 15(3) of the Act.

[77] Mr Hinchcliff argued that the High Court's decision in *Hamilton v Accident Compensation Corporation*[22] supports the proposition that whether or not a tax return is taken

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[21] *Nicholas* above n 6 at [26]; *Davis*, above n 14 at [22]; *Irwin*, above n 15 at [34].
[22] *Hamilton v Accident Compensation Corporation* [2019] NZHC 3109.

into account by the Corporation when determining earnings, the Corporation must apply s 15(3) to determine "reasonable remuneration".

[78] *Hamilton* does not support Mr Hinchliff's argument.[23] Further, *Hamilton* does not address the issues arising in this case. *Hamilton* was concerned with the way in which reasonable remuneration for a shareholder-employee should be calculated under s 15(3) once the Corporation had decided under s 15(1) that the appellant's declared income did not reasonably represent her earnings as a shareholder-employee. The High Court did not consider the circumstances when an assessment under s 15(3) was required.

[79] In *Hamilton*, the Court said that "the starting point is the "subsection (2) amount," which includes shareholder-employee earnings which are all PAYE income payments of that person for an income year derived from the company from which the person is a shareholder-employee.[24] It is only if the Corporation decides that the subsection (2) amount is not a reasonable representation of the person's earnings as a shareholder-employee in the tax year, that subsection (3) will be considered.[25]

[80] In addition, *Hamilton* does not support Mr Hinchcliff's argument that if, as here, a shareholder-employee has nil earnings because of the way that accounting policies have been applied in previous years, the Corporation should set that to one side and instead exercise its discretion under s 15(3).

[81] A similar argument was made unsuccessfully in *Simpson v Accident Compensation Corporation*.[26] In dismissing the appeal, Judge McGuire agreed that *Hamilton* did not establish any principle that where an earner had no earnings for three years, the earner was nevertheless entitled to weekly compensation during the period of incapacity, based on a s 15(3) argument. The facts were similar to the present appeal in that Mr Simpson's company's financial and income tax records showed that in the relevant tax years the company operated at a significant loss each year. Mr Simpson was not allocated and nor did

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[23] See also *Brown,* above n 19 at [49], which confirmed that *Hamilton* does not hold that a tax return must be rejected before section 15(3) applies. In *Hamilton* the Corporation had decided under s 15(1) that the appellant's declared income did not reasonably represent her earnings as a shareholder-employee and the High Court was concerned with how "reasonable remuneration" for a shareholder-employee should be calculated under section 15(3).

[24] Above n 22 at [29].

[25] Above n 22 at [39].

[26] *Simpson v Accident Compensation Corporation* [2022] NZACC 128.

he declare any earnings from employment in those years. Mr Simpson asserted that the work he had done for the company was worth a minimum of $80,000.00 per year.

[82] An application for leave to appeal from the *Simpson* judgment was dismissed by Judge Spiller on 27 September 2022 on the basis that there was no mistake of law evident in Judge McGuire's judgment and that the questions posed by Mr Hinchcliff did not reasonably arise from the judgment for consideration by the High Court.[27] An application to the High Court for special leave to appeal was dismissed by Campbell J on 30 June 2023.[28] Notably relevant to the present appeal, Campbell J stated:[29]

> The Corporation only had to turn to s 15(3) if it decided the amount produced under s 15(2) was not a reasonable representation of Mr Simpson's earnings as a shareholder-employee.

[83] The argument for Mr Watson was that that if he had not been incapacitated, he would have worked and not employed contractors to undertake the work of L & M. He would then have derived additional income during the relevant period rather than nil shareholder earnings.

[84] However Mr Watson's earnings were not "*unreasonably influenced*" as interpreted by the clause 31 cases referred to above - that is, "in some way loaded", "doctored", or "deliberately manipulated" - typically for the purpose of inflating income and the calculation of earnings to assess weekly compensation.

[85] On the financial information provided to the Corporation, there was ample evidence on which the Corporation could conclude under clause 31(b) that Mr Watson's shareholder-employee income tax return and related accounts were not unreasonably influenced by Mr Watson's incapacity or the effects or likely effects of his incapacity on his income or business activities. The Corporation sensibly concluded that Mr Watson's income tax return and accounts were clearly not unreasonably influenced by his incapacity because there was no suggestion of his income being inflated. On the contrary, Mr Watson's returned income was nil and there was nothing to raise any doubt about its correctness. That conclusion was reasonably open on the evidence and I consider that it was correct.

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[27] *Simpson v Accident Compensation Corporation* [2022] NZACC 184.
[28] *Simpson v Accident Compensation Corporation* [2023] NZHC 1661.
[29] *Simpson v Accident Compensation Corporation* [2023] NZHC 1661 at [37].

[86] That being the case, clause 31 directs that the Corporation must take the claimant's relevant income tax return into account. The Corporation was required to take into account any shareholder-employee earnings declared in the relevant tax return to the IRD for the purpose of calculating Mr Watson's base earnings for weekly compensation purposes. Those earnings were clearly nil. That was because of accounting policies applied to offset losses from previous years for tax minimisation tax purposes. It was entirely a matter for the Corporation as to what weight it put on the relevant tax return. It clearly gave substantial weight to the relevant tax return and the Corporation made no error in doing so. The Corporation's decision under clause 31(b) was not plainly wrong and there was no error of law. No irrelevant consideration was taken into account and there was no failure to take account of a relevant consideration.

[87] As is well established by many cases including *Pratley*,[30] if a person structures his (or her) affairs to result in there being no income earned by that person at material times, then entitlement to earnings-related compensation is lost. The provisions governing calculation of weekly compensation are intended to capture only earnings which are income declared in filed tax returns and on which tax is payable. Parliament is unlikely to have intended to provide weekly compensation for lost earnings on which no tax or accident compensation levies are payable.[31]

[88] Turning then to s 15, the Corporation may exercise its discretion under s 15(1)(b) if it decides that nil shareholder-employee earnings are not a "reasonable representation" of earnings in the relevant tax year. But s 15 does not require the Corporation to determine what is a "reasonable representation" of earnings for a particular shareholder-employee's services to a company unless there is a basis for exercising the discretion under s 15(1)(b) to decide that the income declared to IRD is not a "reasonable representation". That is, s 15(3) is only applicable if the Corporation first decides that the amount calculated under s 15(2) is not a reasonable representation of the shareholder-employee's earnings in the relevant tax year.

[89] As with any exercise of discretion, in order for the discretionary decision under s 15(1)(b)), to be set aside, it must be established that the decision was plainly wrong, there

[30] Above n 8.
[31] *Pratley, a*bove n 8.

was an error of law, the Corporation took into account an irrelevant factor, or failed to take into account a relevant factor.

[90] The Corporation did not exercise its s 15(1)(b) discretion in error when deciding not to undertake a s 15(3) calculation, and that nil shareholder-earnings were a reasonable representation of Mr Watson's earnings. That is for the following reasons:

(a) The Corporation's s 15(1)(b) decision is not plainly wrong. The Corporation considered all of the financial information provided to it. That information showed that there were no shareholder-employee earnings in the relevant tax year ending 31 March 2021. Mr Watson's IR3 tax return shows no shareholder-employee earnings declared to the IRD.

(b) There was no error of law or principle. Having considered under clause 31(b) that Mr Watson's and his company's relevant tax returns were not unreasonably influenced by his incapacity or its effects on his income or business activities, the Corporation was required to take Mr Watson's tax return into account in determining Mr Watson's earnings as a shareholder-employee. It was a matter for the Corporation to decide whether to give the relevant tax return substantial weight and it clearly did so.

(c) Ms Roet's memorandum describes the process by which she calculated nil earnings. Clause 39(1) only applies if there are earnings as a shareholder-employee. There is no evidence that she misapplied, or misinterpreted, the financial information provided by Mr Watson in determining that there were no earnings captured by clause 39, and that therefore it could not apply.

(d) Equally, because clause 39 did not apply, there was no basis on which clause 42 could operate, which would otherwise have lifted earnings to the minimum rate.

(e) There was no failure by the Corporation to take account of a relevant consideration. Mr Hinchcliff submitted that the Corporation should have recognised the effect of weekly compensation in calculating Mr Watson's earnings as a shareholder-employee. Mr Watson did receive weekly compensation in the

relevant tax year. If he had been receiving that compensation at the time of his further injury and incapacity those would be regarded as earnings as an employee and therefore could be considered under clause 41.

(f) However, Mr Watson was not receiving weekly compensation at the time of his further injury and incapacity and clause 41 does not apply. There was no failure by the Corporation to take account of Mr Watson's earnings as an employee while he was receiving weekly compensation. In addition, there was no evidence that Mr Watson was receiving earnings at the time his incapacity commenced and this was not something that the Corporation could have taken into account.

(g) To summarise in relation to clauses 39, 41, 42:

[i] Clause 39 does not apply because Mr Watson had no earnings as a shareholder-employee immediately before his incapacity commenced.

[ii] Clause 41 does not apply because Mr Watson had no earnings as an employee at the time his incapacity commenced on 27 August 2021.

[iii] Clause 42 (containing a mechanism to lift earnings to a minimum statutory rate) does not apply because it is engaged only if clause 39 applies. Clause 39 does not apply because Mr Watson had no earnings as a shareholder-employee immediately before his incapacity commenced.

(h) The Corporation did not take account of any irrelevant consideration. The Corporation sought further information in order to assess whether there had been a significant change in the company, and whether a shareholder salary would reasonably have been expected in the income year in which the incapacity arose. Ms Roets concluded that there was not.

Conclusion

[91] No error has been established in the Corporation's Decision of 19 January 2022 or the Review Decision. The Corporation was correct in determining that Mr Watson had nil earnings as a shareholder-employee for the year ending 31 March 2021 for the purpose of

calculating his base weekly compensation. The Corporation made no error in taking into account and giving substantial weight to the relevant income tax return and financial statements provided and was not required to calculate an amount which represented "reasonable remuneration" for the relevant tax year under s 15(3) of the Act.

Result

[92] The Corporation's Decision of 19 January 2022 and the Review Decision are correct and are confirmed.

[93] The appeal is dismissed.

Costs

[94] Although Mr Watson is unsuccessful on appeal, I make no order for costs.

I C Carter
District Court Judge

Solicitors/Representatives: ACC and Employment Law, Ellerslie, Auckland, for appellant
Young Hunter, Solicitors, Christchurch, for respondent