

**IN THE EMPLOYMENT RELATIONS AUTHORITY  
AUCKLAND**

AA 406/08  
5137172

BETWEEN                    RICHARD CHALLIS  
   Applicant  
  
AND                            MANUKAU CITY COUNCIL  
   Respondent

Member of Authority:     R A Monaghan  
  
Representatives:           M Smyth, Counsel for Applicant  
   E Davies, Counsel for Respondent  
  
Submissions received:    11 and 13 November 2008 from Applicant  
   11 November 2008 from Respondent  
  
Determination:            1 December 2008

---

**DETERMINATION OF THE AUTHORITY**

---

**Employment relationship problem**

[1] Richard Challis and his former employer, the Manukau City Council ("the Council"), are parties to a settlement recorded under s 149 of the Employment Relations Act 2000.

[2] Mr Challis says the Council has failed to comply with a term of the settlement in that income tax was deducted from the payment specified in clause 3 of the agreement. Mr Challis says the deduction should not have been made and seeks:

- (a) a determination as to whether, on the true construction of the clause, the sum concerned was payable gross or net of tax;
- (b) a compliance order requiring the Council to reimburse him for the balance of the sum payable;
- (c) interest; and
- (d) costs.

[3] By agreement with the parties, this matter was heard on the papers.

### **The agreement**

[4] The underlying employment relationship problem concerned Mr Challis' personal grievance on the ground of unjustified dismissal, as well as whether certain intellectual property was created within the scope of his employment. The problem was filed in the Authority and subsequently settled by the agreement with which this problem is concerned.

[5] The agreement obliged the Council to, among other things: reimburse Mr Challis for his lost earnings (in a specified amount stated to be 'gross'); and pay him a specified sum under s 123(1)(c)(i) of the Employment Relations Act. The disputed clause read:

"3. The Council will pay to Mr Challis \$x (gross). This payment is intended to cover Mr Challis' legal costs (\$y) and any other lost benefits (\$z)".

[6] When making payment under this clause the Council deducted income tax at source, so that Mr Challis received the equivalent of the full sum I have identified as \$x less income tax on that amount. I have not specified the sums detailed in the clause because it is not necessary for the purposes of this determination and because the terms of the agreement were confidential. The deduction of tax from the total overall payment was made in reliance on the presence of the word 'gross'. Accordingly the issue between the parties centres on the meaning and application of the word 'gross'.

### **The meaning of the word 'gross'**

[7] It was common ground that the words used in the agreement must be given their natural and ordinary natural meaning.

[8] Mr Challis says the natural and ordinary meaning of the word 'gross' is 'without deduction' so that the sum specified in clause 3 should have been paid 'without deduction'. He denies that the word 'gross' means 'subject to tax'. He says

a reasonable person would expect the words 'subject to tax' or 'net of tax' to be used if the parties' intention was that a specified sum be paid after the deduction of tax.

[9] The Council says the natural and ordinary meaning of the word 'gross' is, according to the New Shorter Oxford Dictionary and the New Zealand Oxford Dictionary, 'not net'. 'Net' in turn means 'not subject to any deduction' or 'remaining after all necessary deductions or free from deductions.' Mr Challis is saying in effect that he should have received the full payment net of tax. If the clause had that intention, it would have said so. By using the word 'gross', the parties made it clear that tax was to be deducted.

[10] In this context the natural and ordinary meaning of the word 'gross' can indeed be defined as the Council has. Particularly relevant is the phrase 'remaining after all necessary deductions....' Thus I do not accept that the mere use of the word 'gross' amounts to an agreement or acceptance that tax is actually payable on the sum in question, let alone that it creates an obligation on the part of the payer to deduct and remit any payment of tax regardless of whether the payment is otherwise taxable. If no deduction is necessary, the word 'gross' cannot be applied to create such necessity.

[11] For example, often it is obvious that a particular kind of payment is taxable and a deduction is necessary - so that here the use of the word 'gross' in the clause relating to the reimbursement of lost earnings causes no difficulty. However the matter is not always obvious, and the correct status of a payment may ultimately be one for the IRD to determine. Meanwhile the use of the word 'gross' in a settlement agreement is simply a method of indicating that such deduction as is necessary is incorporated in the agreed sum rather than being payable in addition to it.

[12] I consider that here, in saying the use of the word 'gross' means the specified payment must first have tax deducted from it, the Council is going too far.

[13] According to clause 3 the payment comprises a payment for 'legal costs' and a payment for 'other benefits'. The meaning of 'legal costs' is not disputed. Payments in respect of legal costs are essentially reimbursing payments and are not taxable as income in the hands of the person receiving the payment. The natural and ordinary

meaning of the word 'gross' cannot extend to creating the necessity for a deduction when there is otherwise no such necessity.

[14] Here the Council has treated a deduction as necessary because, with reference to the course of the parties' settlement negotiations, it says it has had regard to its obligations regarding transparency and is concerned about a possibility that characterising the payment as 'legal costs' might be viewed as a sham.

[15] If it had that concern, however, it should not have agreed to pay 'legal costs' in the specified sum at all. Further, if it wished to satisfy itself that the payment was genuine in the context of an agreement to meet or contribute to legal costs, it could have asked for invoices in support before agreeing to the payment. Since the payment has been identified in the agreement as a payment of legal costs, the question of whether it is genuinely a reimbursing payment rather than a payment of income is one for the IRD to resolve if any issue arises. It is not for the Council to act on its view of the true taxable nature of the payment by imposing a strained meaning of the word 'gross'.

[16] Nothing in these remarks should be taken as indication on the Authority's part that the payment may be a sham. Indeed the sum concerned is modest on its face, and there is nothing in the overall history of the employment relationship problem as it was put to the Authority to suggest it cannot be supported.

[17] As for the 'other benefits' referred to in clause 3, the agreement does not specify what they are although I understand the parties are able to identify them. If the associated payments are taxable by virtue of the nature of the benefit concerned, then the word 'gross' means tax should be deducted and the balance paid to Mr Challis. If the payments are not taxable, it is not for the Council to form its own view of the matter and make a deduction of tax in reliance on the word 'gross'.

### **Orders of the Authority**

[18] For the above reasons, the Council was in breach of clause 3 in that it did not pay to Mr Challis the full amount owed under that clause.

[19] It is ordered to comply with the clause by paying to Mr Challis the amount of the tax deducted in respect of the payment of 'legal costs'.

[20] I cannot comment on whether the payment in respect of 'other benefits' referred to in clause 3 was taxable or not. If it was, then any deduction in respect of tax was properly made and Mr Challis is not entitled to any further payment. Any conclusion about the taxable nature of the payment is to be based on an application of ordinary principles and is not to be affected by the wider concerns of the kind expressed to the Authority here. The Council cannot purport to redefine for tax purposes a payment to which it has expressly agreed.

[21] If the payment was not taxable, then the deduction was not properly made and the Council is further ordered to comply with clause 3 by reimbursing Mr Challis accordingly.

[22] The Council is ordered to pay interest on the sum identified under [19], as well as any sum identified under [21], calculated at the rate of 7.8% from the date of the breach of clause 3 to the date of payment.

#### Costs

[23] Costs are reserved.

[24] The parties are invited to agree on the matter. If they are unable to do so any party seeking an order for costs shall have 28 days from the date of this determination in which to file and serve a memorandum on the matter. The other party shall have a further 7 days from the date of receipt of the memorandum in which to file and serve any reply.



R A Monaghan

Member of the Employment Relations Authority

