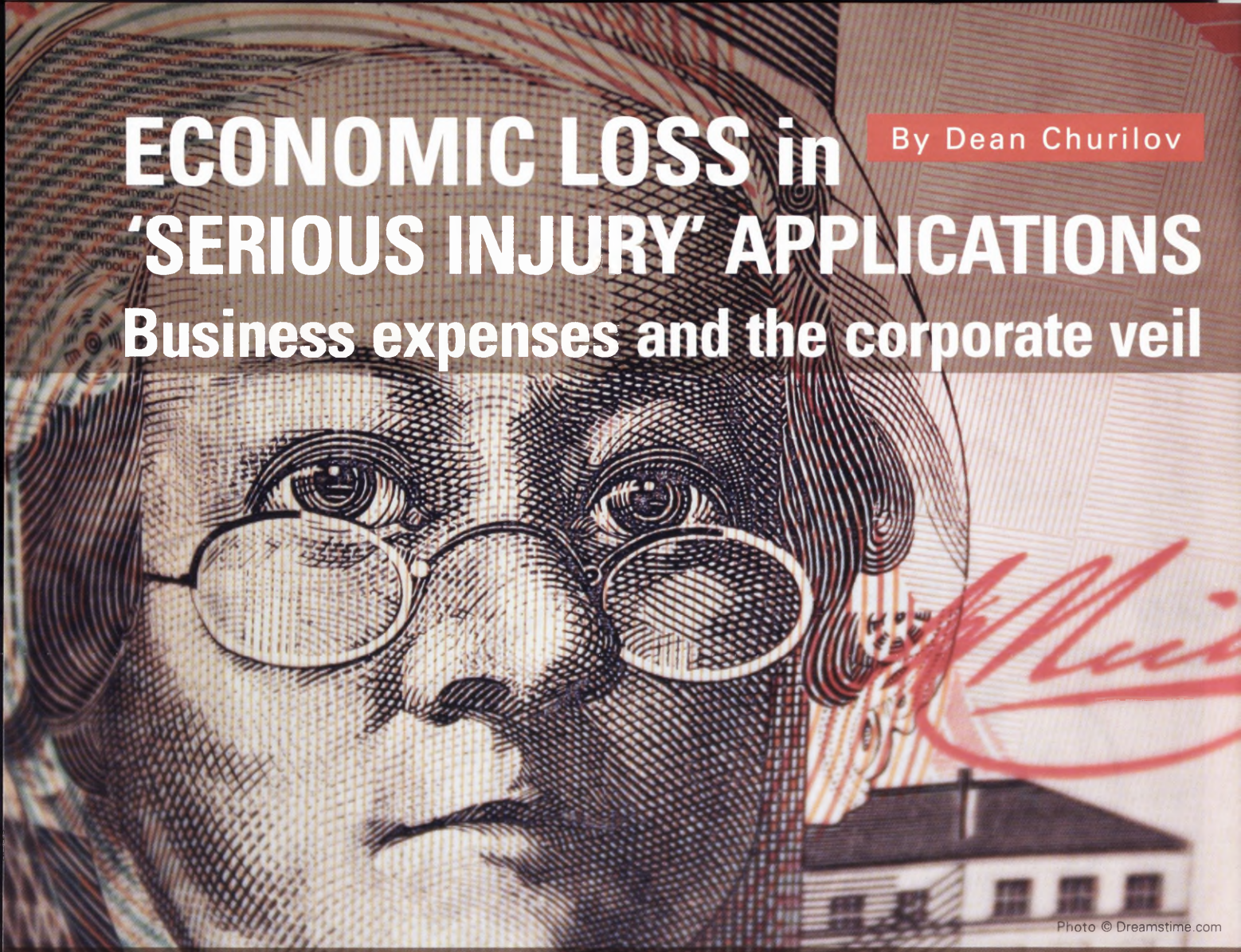
ECONOMIC LOSS in 'SERIOUS INJURY' APPLICATIONS

Business expenses and the corporate veil

By Dean Churilov



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Historically, and through to the present day, establishing requisite loss of earning capacity under s134AB(38) of the *Accident Compensation Act* 1985 (the Act), in 'serious injury' applications lodged in accordance with s134AB(4), has proven to be both difficult and confusing. Particularly in circumstances where the worker was self-employed, running his or her own business through an incorporated company, or through the use of a trust, during the 'without injury' period[1] or as at the date of the determination of his or her application.[2]

It is critical to get the economic loss component of 'serious injury' applications right in light of the drastic costs consequences imposed by *The WorkCover (Litigated Claims) Legal Costs Order 2010*.[3]

'INCOME FROM PERSONAL EXERTION'

While this expression[4] – used by the Act in terms of the requisite comparison between *'without* injury' and *'after injury'* earnings as a measure of the worker's loss of earning capacity – is fairly straightforward in circumstances where the workers are not self-employed, the reverse is true in situations where they are.

A common, important question that arises in this context is whether the above definition of income from personal exertion incorporates payments made to workers other than as employees' salaries or wages, such as directors' fees and/or wages, as well as distribution of profits through a trust.

In *Glazebrook v Accident Compensation Commission*[5] (*Glazebrook*), the Full Court of the Victorian Supreme Court (Crockett, O'Bryan and Vincent JJ) considered the meaning of *'earnings'* in the context of s93 of the Act.

'Earnings' was held to have an unrestricted meaning, in the context of the Act, wider than *'remuneration'*, thus being given its ordinary meaning *'money earned, wages, profits'* rather than *'remuneration'* meaning *'pay for services rendered or work done'* (citing and applying *Connally v Victorian Railways Commissioner* [1957] VR 466[6]).

It is arguable that the Act prescribes a wide and unrestricted meaning to *'income from personal exertion'*, incorporating not only, among other items, *'earnings* (in the popular sense of the word) *received in the capacity of employee'*, but also monetary reward of a different character to earnings *'in relation to any services rendered'* by workers. The Act recognises that workers may be paid for services rendered, as part of their remuneration packages, other than in the capacity of employees – that is, as directors or as trust beneficiaries.

In respect to profit distributions through a trust, Ashley JA in *Azzopardi Haulage Pty Ltd & Anor v Azzopardi*[7] *(Azzopardi)*, while considering ss92A and 92B of the Act, stated:

> 'Against that background, the appellant's counsel did not contend that a distribution of profits could never be a component of earnings. That would have been a hopeless proposition. Neither, as I noted earlier, did he contend that a discretionary distribution of a part of the profits earned by the trustee of a trust to a person who was both employed by the trustee and was a beneficiary of the trust could never be a component of earnings.'[8]

'PROCEEDS OF BUSINESS'[9]

As things stand at present, judges of the county court are divided as to the meaning to be attributed to *'the proceeds of any business'*, particularly as to whether such proceeds are to be considered in gross terms, without deduction of business expenses, or whether they are to be considered in 'nett' terms, after such a deduction.

In *Glazebrook*, it was submitted on behalf of the Accident Compensation Commission that the worker was entitled to receive compensation only in respect of his *'earnings'* from personal exertion and, accordingly that any part of his *'earnings'* paid as expenses of operating the delivery truck should be deducted. The Full Court, citing and applying *Connally v Victorian Railways Commissioner*, held that *'earnings'* meant the full sum for which the worker was engaged to work without deduction of any expenses incurred by the worker.

Wilmoth,[10] Strong,[11] Misso,[12] Bourke,[13] Lewitan[14] and Lawson[15] JJ have all adopted the 'gross business proceeds' interpretation, while on the other hand, Davey,[16] Pannam[17] and Coish[18] JJ have all adopted the 'nett business proceeds' interpretation.

PIERCING THE CORPORATE VEIL

There is an uncertainty as to whether the court hearing the 'serious injury' application should pierce the corporate veil, particularly in circumstances of the worker not being the sole employee and shareholder of the incorporated company.

In *Stephen Alter v Alcon Laboratories (Australia) Pty Ltd (Alter)*, the worker incorporated a company post-injury. The company's business involved applying the technical know-how that the worker had obtained through his training and through subsequent experience.[19] The worker's wife did office work, for which she was paid a regular wage. Her role in the company was the management of the business and anything to do with the administration side of the business.[20]

Misso J essentially accepted the submissions on behalf of the worker that *Husher v Husher* [21] *(Husher)* should be distinguished. As opposed to a partnership, the worker and his wife were employees of an incorporated business, performing legitimate roles contributing to the fortunes of the company. It was decided that the corporate veil should not be pierced and the income generated by the company should not be treated as that of the worker.[22] Misso J did not have to reach a conclusion as to whether *Husher* permitted the corporate veil to be pierced. As such, Misso J found that it was inappropriate to treat the gross income generated by the company as that of the worker and, instead, the relevant income of the worker was that earned by him as an employee of the company only.

In *McLaren v Dubbo Grazing Services (McLaren)*, Bourke J specifically adopted Misso J's reasoning in *Alter*, emphasising incorporation and the employment of the worker by the company alongside a large team of workers.[23]

However, the number of employees employed by the company, in addition to the self-employed worker, does not seem to be that decisive. In *Michael Roberton v Access Door Services & Anor*,[24] Bourke J reached the same conclusion as in *McLaren*, despite the fact that the worker was the sole director, shareholder and employee of the company as trustee of the family trust.

> In *Azzopardi*, the key issue was whether earnings included trust profit distributions, or whether they were confined to wages paid by the company.

In submissions on behalf of the employer, it was put to the court that while the corporate veil may be cast aside in the common law proceedings, it could not happen in the case of 'serious injury' applications.[25] Bourke J essentially accepted these submissions and distinguished the decision of South Australian Full Court in *Spargo v Haden Engineering Pty Ltd*,[26] which was cited in *Husher*.

On the other hand, in *Geoff Boyse v Kodak (Australasia) Pty Ltd*,[27] Lawson J accepted that the gross income generated by the company should be attributed as that of the worker, notwithstanding that he operated his business through an incorporated entity, with the decisive factors being that the worker was a sole shareholder and employee, that he was solely responsible for generating the company's income and that the nett profit was distributed solely to him.[28]

Consideration of the abovementioned county court authorities may lead one to fall into the trap of ignoring the importance of facts in each case, which the High Court in *Husher* warned against, and in seeking *'to classify cases as concerning "sole traders" or "partnerships" or "wage-earners" or "trading trusts" and* >>

then attempting to deduce some rule of general application to all cases falling with the classification thus devised'.[29]

FACTORS TO BE CONSIDERED

In *Azzopardi*, the key issue before the Victorian Supreme Court of Appeal was whether earnings included trust profit distributions, or whether they were confined to wages paid by the company.

The deceased worker originally had a simple partnership with his wife in his transport business. He worked exclusively for Eatmore Poultry (Baiada) and after a number of years he was asked to incorporate, failing which he would no longer have been given work by Baiada. At that point, the deceased worker incorporated Azzopardi Haulage Pty Ltd, as trustee for a family trust.

The deceased worker and his wife were the directors, shareholders and office-holders. He drove a truck and generated income, while she took care of the administrative side and paperwork. About 12 months before the fatal accident, the deceased worker's son joined the business as an employee, driving a second truck.

The court identified a number of factors that, taken in conjunction, enabled the drawing of an inference that the family trust distributions were part of the agreed earnings of the deceased worker and his wife.[30]

Analysis of the following relevant factors, as laid down in *Azzopardi*, having regard to the facts of 'serious injury' applications before the court, will ensure consistency, and avoid anomalous results:

- the history of the structure of the business preceding its incorporation (that is, any change from partnership to incorporation and reasons for the change);
- whether incorporation was forced (having regard to the past conduct of the business and the circumstances forced upon the worker will help to ascertain the probable basis upon which the company's financial affairs proceeded following incorporation);
- whether the wages paid to the worker were high or low when compared with the amount of profit distributions (low wages could suggest that the profit distributions were part of the remuneration package for the worker's services rendered to the company);
- the existence of an employment agreement, whether formal or informal, which in conjunction with other factors provided that the worker would be rewarded in return for his or her work through the making of profit distributions earned by the company; and
- whether profit distributions formed a part of the worker's taxable income.

The arrangements adopted by workers to distribute profits – that is, through the use of an incorporated entity, a family trust or a partnership – are matters of form, not substance, which should not distract from having *'regard to the realities and motivations underlying the arrangements which have been made'*.[31]

Legal practitioners should take special care in ascertaining and analysing all relevant facts relating to the businesses operated by workers, in the context of 'serious injury' applications, particularly those relating to the areas of business expenses and distribution of profits which have to date caused a significant amount of confusion and ambiguity. Such careful preparation and analysis should not only increase the rate of success of these applications, in terms of economic loss, but also ensure legal representation with due care, skill and attention. ■

Notes: **1** Section 134AB38(f)(ii). **2** Whether by the Victorian WorkCover Authority (VWA) under s134AB(16)(a) or at the date of the hearing of the applicaton by the court under s134AB(16)(b) (s134AB(38)(e)(i)). **3** [4], Part A. **4** Contained in s134AB(38)(f)(i) and s134AB(38)(f)(ii). **5** [1988] VR 454. **6** At 456. **7** [2008] VSCA 241. **8** At [62]. **9** Section 134AB(38) and s6(2)(b) of the *Transport Accident Act* 1986. **10** *R Caratozzolo v Metroll Pty Ltd & Anor* [2007] VCC 1006 at [99]. **11** *Stevo Boskovic v Road Maintenance Pty Ltd (ACN 006 798 796)* [2006] VCC 51 at [73]. **12** *Stephen Alter v Alcon Laboratories (Australia) Pty Ltd* [2008] VCC 713 at [74], [79]. **13** *McLaren v Dubbo Grazing Services* [2009] VCC 0526 at [138]. **14** *AW Thompson v Concept Hiring Services* VCC (14/11/08). **15** *Geoff Boyse v Kodak (Australasia) Pty Ltd* VCC [2009] at [110]. **16** *Nhat Phuong Nguyen v Toyota Motor Corporation Australia Limited* [2006] VCC at [36], [37]. **17** *Brian John Peoples v I&C Hunt Pty Ltd* [2005] VCC 1138 at [35], [36]. **18** *Guthrie v Campon Education (Aust) Pty Ltd* [2009] VCC 1141 at [41]. **19** At [68]. **20** At [84]. **21** [1999] HCA 47. **22** At [83]. **23** At [138]. **24** [2008] VCC. **25** At [318]. **26** (1993) 60 SASR. **27** VCC [2009]. **28** At [110]. **29** Gleeson CJ, Gummow, Kirby and Hayne JJ at [23]. **30** Ashley JA at [86]. **31** *Husher v Husher* [1999] HCA 47, Callinan J at 54].

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