

GSTD 2002/D4 - Goods and Services Tax: is the payment of judgment interest consideration for a supply?



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This document has been finalised.

Draft Goods and Services Tax Determination

Goods and Services Tax: is the payment of judgment interest consideration for a supply?

Preamble

Draft Goods and Services Tax Determinations (DGSTDs) present the preliminary, though considered, views of the Australian Taxation Office. DGSTDs should not be relied on; only final Goods and Services Tax Determinations represent authoritative statements by the Australian Taxation Office.

1. No. The payment of judgment interest is not consideration for a supply for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act).

Background

2. Goods and Services Tax Ruling GSTR 2001/4 considers the GST consequences resulting from court orders and out-of-court settlements. It explains how a payment (or act or forbearance) that is made in compliance with a court order or out-of-court settlement is treated for the purposes of the GST Act.

3. Payments made in compliance with a court order may include amounts of judgment interest. The GST treatment of the payment of judgment interest was not explained in GSTR 2001/4. However, the concepts and principles developed in GSTR 2001/4 are utilised in providing that explanation in this Determination.

4. This Determination does not apply to a payment of judgment interest where section 78-110 of the GST Act applies to the payment.¹

¹ Section 78-110 of the GST Act states:

If:

- (a) *in compliance with a judgment or order of a court relating to:*
 - (i) *a claim under an insurance policy; or*
 - (ii) *a claim by an insurer in exercising rights of subrogation in respect of an insurance policy; or*
 - (iii) *a claim for compensation under a statutory compensation scheme;*
 - an entity makes a payment of money, makes a supply, or makes both a payment of money and a supply; and*
 - (b) *had the payment or supply been made in the absence of such a judgment or order, it would have been a payment or supply made in settlement of the claim;*
- the payment or supply is treated as having been made in settlement of the claim.*

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GSTR 2001/4

5. An essential requirement of a taxable supply is that the supply is made for consideration.² GSTR 2001/4 explains that, for there to be a supply for consideration, three fundamental criteria must be met:

- there must be a supply;
- there must be a payment; and
- there must be sufficient nexus between the supply and the payment for it to be a supply for consideration.³

Supplies relating to a court order

6. GSTR 2001/4 explains that supplies that are related to a court order fall within two categories, which it labels *earlier supplies* and *current supplies*.⁴ Where the subject of the dispute is an earlier transaction in which a supply was made involving the parties to the dispute, GSTR 2001/4 refers to that supply as an *earlier supply*. Where a new supply is created by the terms of a court order, GSTR 2001/4 refers to that supply as a *current supply*.

7. Earlier supplies and current supplies, where applicable, are not made by the court, but by the parties to the dispute. Although it is the judgment of the court and its associated orders that ‘settles’ a dispute, GSTR 2001/4 explains that, in giving a judgment, a court does not make a supply for GST purposes.⁵

8. A dispute resolved by the court may have arisen over a matter that does not relate to a supply at all. For example, a grievance suffered by a party for which an order for damages is sought from the court, does not constitute a supply made by the aggrieved party.⁶

Payment and sufficient nexus

9. A payment is consideration for a supply if the payment is ‘in connection with’, ‘in response to or for the inducement of’ the supply.⁷ It does not matter whether the payment is in compliance with an order of a court, or of a tribunal or other body that has the power to make orders.⁸

² Paragraph 9-5(a) of the GST Act.

³ Paragraph 21 of GSTR 2001/4.

⁴ Paragraph 68 of GSTR 2001/4. Paragraphs 69 and 70 explain that there are no ‘discontinuance supplies’ in relation to a dispute resolved by a court order. ‘Discontinuance supplies’, which arise in relation to out-of-court settlements, are discussed at paragraphs 50 to 55.

⁵ Paragraph 60 of GSTR 2001/4.

⁶ Paragraphs 71 to 73 of GSTR 2001/4.

⁷ Subsection 9-15(1) of the GST Act; paragraph 67 of Goods and Services Tax Ruling GSTR 2001/6, dealing with non-monetary consideration.

⁸ Subsection 9-15(2A) of the GST Act.

10. A payment is consideration for a supply if there is sufficient nexus between the supply and the payment made.⁹ The test as to whether there is a sufficient nexus is an objective test.¹⁰

Judgment interest

11. Pre-judgment interest and post-judgment interest are both awarded by the courts.

Pre-judgment interest

12. The award of pre-judgment interest goes further than the pure commercial concept of payment for use of money. It is based on a broader concept of compensation for being deprived of the use of the money. In *Whitaker v Federal Commissioner of Taxation* (1998) 38 ATR 219 at 227; 98 ATC 4285 at 4291, Lockhart J stated:

The primary purpose of an award of pre-judgment interest is to compensate a successful plaintiff for the loss or detriment which he or she has suffered by being kept out of his or her money during the relevant period; that is to compensate the plaintiff having been deprived of the use of the money: *Ruby v Marsh* (1975) 132 CLR 642; *Bachelor v Bourke* (1981) 148 CLR 448; and *MBP (SA) Pty Ltd v Gogic* (1991) 171 CLR 657....

13. The power to award pre-judgment interest exists irrespective of the cause of action, with the claim for interest considered to be separate and distinct from the underlying claim in the cause of action. The resulting assessment of the interest is over and above the awarding of the damages by the court or jury.¹¹ Accordingly, we consider the awarding of pre-judgment interest is separate to the cause of action and has no connection to any supply which may be the basis of the cause in action.

14. As there is no connection to a supply which may be the basis of the cause in action, pre-judgment interest is not additional consideration for those supplies. We consider that there is not sufficient nexus between a payment of pre-judgment interest and any earlier supply relating to the dispute, nor to any current supply arising out of the court order finalising the dispute.

Example 1 – earlier supply and pre-judgment interest

15. *Mirrors Galore, a GST registered mirror retailer, receives a supply of mirrors from a GST registered supplier. On delivery, Mirrors Galore discovers that some of the mirrors are cracked. It approaches the supplier for a refund of \$55,000, being the price it paid for the cracked mirrors. The supplier refuses to refund any part of the consideration paid. Mirrors Galore sues the supplier for \$55,000. They also include a claim for pre-judgment interest. The court rules in favour of Mirrors Galore, awarding \$55,000 plus pre-judgment interest of \$5,000.*

16. *As the pre-judgment interest is not connected to the earlier supply of mirrors, it is not a repayment of consideration for that supply.*

⁹ Paragraph 68 of GSTR 2001/6 .

¹⁰ Paragraph 72 of GSTR 2001/6.

¹¹ *Ruby v Marsh* (1975) 132 CLR 642 at 644

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Post-judgment interest

17. Post-judgment interest is interest on the sum awarded in the original judgment from the date of that judgment to the date of payment. It is payable solely because of the delay in the payment of the judgment debt. Entitlement to post-judgment interest is determined in accordance with the relevant statutory provisions.¹²

18. Post-judgment interest has no connection with the underlying cause of action. Once the plaintiff has succeeded and judgment has been entered for a sum which includes the pre-judgment interest, the cause of action which led to the judgment has merged in the judgment.¹³

19. As post-judgment interest has no connection with the underlying cause of action, we consider that it is not connected with any earlier supply. In addition, as post-judgment interest is interest on a sum awarded in judgment, the payment of post-judgment interest is not consideration for any current supply.

Example 2 – post-judgment interest

20. *After several months, the supplier from example 1 still had not paid the judgment debt of \$60,000. Mirrors Galore takes further legal action seeking post-judgment interest to compensate for the delay in payment of the judgment debt.*

21. *The court rules in favour of Mirrors Galore and awards post-judgment interest of \$3,000. The post-judgment interest is not consideration for any supply.*

Financial supply consequences of the payment of judgment interest

22. Financial supply has the meaning given by the A New Tax System (Goods and Services Tax) Regulations 1999 (the regulations).¹⁴ Subdivision 40-A of the regulations deals specifically with financial supplies. In accordance with subdivision 40-A, the provision, acquisition or disposal of an interest in or under a debt or credit arrangement is a financial supply if the requirements of subregulation 40-5.09(1) are satisfied.¹⁵

23. Goods and Services Tax Ruling GSTR 2002/2, dealing with the GST treatment of financial supplies and related supplies and acquisitions, explains when something is a

¹² For example, in New South Wales, it is determined in accordance with section 95 of the *Supreme Court Act 1970*.

¹³ *Whitaker v Commissioner of Taxation* (1998) 38 ATR 219; 98 ATC 4285.

¹⁴ Subsection 40-5(2) of the GST Act.

¹⁵ The requirements set out in subregulation 40-5.09(1) are that:

- (a) the provision, acquisition or disposal is:
 - (i) for consideration; and
 - (ii) in the course or furtherance of an enterprise; and
 - (iii) connected with Australia; and
- (b) the supplier is:
 - (i) registered or required to be registered; and
 - (ii) a financial supply provider in relation to supply of the interest.

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financial supply.¹⁶ GSTR 2002/2 uses the term 'financial interest' to describe an interest in or under a debt or credit arrangement.¹⁷

24. Judgment interest is part of a debt owed to the judgment creditor and is not consideration for a supply of a credit arrangement for the purposes of subregulation 40-5.09(3). Payment of judgment interest does not involve the provision or acquisition of a financial interest. However, the disposal of a financial interest may be a financial supply.

25. In our view the payment of judgment interest does not involve a disposal, either by the judgment debtor or the judgment creditor, of an interest in or under a debt. When judgment interest is paid, the debt is merely extinguished by the payment, which being a supply of money, is not a supply.¹⁸ The extinguishment of a judgment debt by its payment does not constitute a supply by the judgment creditor for GST purposes.¹⁹

26. As this extinguishment is not a supply, the payment of the judgment interest is not consideration for a supply for GST purposes.

Your comments

27. We invite you to comment on this draft Goods and Services Tax Determination. We are allowing 6 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date: 8 January 2003

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Related Rulings/Determinations:

GSTR 2001/4; GSTR 2001/6; GSTR 2002/2

¹⁶ Paragraphs 19 to 44 of GSTR 2002/2.

¹⁷ GSTR 2002/2 uses the term 'financial interest' to describe an interest in or under any matter mentioned in an item in the table in subregulation 40-5.09(3).

¹⁸ Unless it is supplied as consideration for a supply that is a supply of money - see subsection 9-10(4) of the GST Act.

¹⁹ Paragraph 67 of GSTR 2001/4. Support for this view is found in the judgment of Underwood J in *Shaw v Director of Housing and State of Tasmania* (No. 2) (2001) 46 ATR 242 at 247; 2001 ATC 4054 at 4058.

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Subject references:

- consideration
- supplies and acquisitions
- supplies without consideration

Legislative references:

- ANTS(GST)A 1999 9-5
- ANTS(GST)A 1999 9-5(a)
- ANTS(GST)A 1999 9-10(4)
- ANTS(GST)A 1999 9-15(1)
- ANTS(GST)A 1999 9-15(2A)
- ANTS(GST)A 1999 40-5(2)
- ANTS(GST)A 1999 78-110
- ANTS(GST)Regs 1999 Subdiv 40-A
- ANTS(GST)Regs 1999 40-5.09
- ANTS(GST)Regs 1999 40-5.09(1)
- ANTS(GST)Regs 1999 40-5.09(3)

Case references:

- *Bachelor v Bourke* (1981) 148 CLR 448
- *MBP (SA) Pty Ltd v Gogic* (1991) 171 CLR 657
- *Ruby v Marsh* (1975) 132 CLR 642
- *Shaw v Director of Housing and State of Tasmania* (No. 2) (2001) 46 ATR 242; 2001 ATC 4054
- *Whitaker v Federal Commissioner of Taxation* (1998) 38 ATR 219; 98 ATC 4285

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