

GSTR 2001/4 - Goods and Services Tax: GST consequences of court orders and out-of-court settlements

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! This document has changed over time. This is a consolidated version of the ruling which was published on *15 July 2020*

4. This Ruling does not deal with settlements of insurance claims. Division 78 of the GST Act deals specifically with settlements of this nature¹.
5. Unless otherwise stated, all legislative references in this Ruling are to the GST Act.

Date of effect

6. This Ruling explains the Commissioner's view of the law as it applies both before and after its date of issue (subject to the following notes). You can rely upon the original Ruling on and from its date of issue for the purposes of former section 105-60 or section 357-60 of Schedule 1 to the *Taxation Administration Act 1953* (as applicable). You can also rely on subsequent addenda notices issued from the dates specified in the individual notices for the purposes of former section 105-60 or section 357-60 of Schedule 1 to the *Taxation Administration Act 1953* (as applicable).

6A. [Omitted.]

6B. [Omitted.]

Context

7. This Ruling analyses the concept of supply and the nexus that must exist between payment and supply in order to establish the relationship of a 'supply for consideration'.² As explained later in the ruling, a payment will not necessarily be consideration for a supply.
8. The ruling begins by analysing the concept of 'supply'. It does this by examining the statutory definition of the term in section 9-10, and comparing this definition with the meaning the term has in overseas jurisdictions, namely the United Kingdom, New Zealand and Canada. Similarities and differences are highlighted. This analysis is found at paragraphs 22 to 73.
9. The Ruling then analyses the critical 'nexus' requirement that must be satisfied to establish the 'supply for consideration' relationship. This analysis is found at paragraphs 80 to 99.

¹ See Goods and Services Tax Ruling GSTR 2006/10 *Insurance settlements and entitlements to input tax credits*.

² Paragraph 9-5(a) refers.

10. In each of the above analyses, the Ruling looks at the concepts in a general sense, then more specifically within the context of court orders and out-of-court settlements.

11. Commencing at paragraph 100, the Ruling then gives the Commissioner's views on where and if a sufficient nexus exists between payment and supply, in the context of a court order and out-of-court settlement.

12. The Ruling then explains the need for apportionment of undissected payments (paragraphs 115 to 125), the GST consequences of a payment under a court order or settlement being consideration for a supply (paragraphs 126 to 136), transitional issues (paragraphs 137 to 144), and the award or negotiation of costs (paragraphs 145 to 155).

Ruling with explanations

13. Matters in dispute may be resolved either by the judgment of a court, or (at a time prior to the court delivering its judgment) by agreement between the parties. An agreement between the parties is referred to in this Ruling as an out-of-court settlement. Out-of-court settlements will include any form of dispute resolution in which the terms of the resolution are agreed between the parties, rather than imposed by the court. Some examples of this are:

- (i) the parties obtain a consent order, the draft of which has been agreed to in a settlement deed;
- (ii) they agree to have the action struck out without a consent order;
- (iii) they enter into an agreement settling their differences before court action commences.

14. In this Ruling, a court order refers to the terms laid down by a court in accordance with its judgment in respect of a dispute.

15. A reference to a 'court' in this Ruling includes a reference to a tribunal or other body that has the power to make orders.

16. A reference to a 'payment' in this Ruling includes a reference to an act or forbearance. A payment will not necessarily be consideration for a supply. It will become consideration if it satisfies the definition of that term in section 195-1. Discussion of 'consideration' commences at paragraph 74.

- (ii) there must be a payment (see paragraph 74 onwards);
and
- (iii) there must be a sufficient nexus between the supply and the payment for it to be a supply for consideration (see paragraph 100 onwards).

What is a ‘supply’?⁵

22. Essentially, a supply is something which passes from one entity to another. The supply may be one of particular goods, services or something else.

23. ‘Supply’ is defined in subsection 9-10(1) as ‘any form of supply whatsoever’. In the UK the term ‘supply’ has been held to take its ordinary and natural meaning, being ‘to furnish or to serve’.⁶ Similarly, the definition of ‘supply’ in the Macquarie Dictionary is ‘to furnish or provide (something wanting or requisite: *to supply electricity to a community*)’. The term refers to things passing from one party to another.

24. Without limiting these general meanings, subsection 9-10(2) provides a non-exhaustive list of activities or occurrences that are included within the meaning of supply. The list is as follows:

- (a) a supply of goods;
- (b) a supply of services;
- (c) a provision of advice or information;
- (d) a grant, assignment, or surrender of real property;
- (e) a creation, grant, transfer, assignment or surrender of any right;
- (f) a financial supply;
- (g) an entry into, or release from an obligation:
 - (i) to do anything; or
 - (ii) to refrain from an act; or
 - (iii) to tolerate an act or situation;
- (h) any combination of any 2 or more of the matters referred to in paragraphs (a) to (g).

⁵ The following analysis is based largely on Goods and Services Tax Ruling GSTR 2006/9, titled ‘Supplies’.

⁶ *Carlton Lodge Club Ltd v. C & E Commrs* [1974] 3 All ER 798, at 801; *C & E Commrs v. Oliver* [1980] 1 All ER 353, at 354-355.

Transactions which are supplies of rights or obligations

31. It has been found in overseas cases that the surrender of a right or the entering into of an obligation does not, without more, constitute a supply of services. This is despite the term 'services' being defined to include them.

32. For example, in the Court of Justice of the European Community (ECJ) case *Landboden-Agrardienste GmbH & Co. KG v. Finanzamt Calau* [1998] BVC 70, the issue was whether the 'supply of services', within the meaning given by the Sixth Directive, extended to an undertaking given by a farmer to reduce its harvest of a potato crop¹⁵. The undertaking appeared to constitute 'an obligation to refrain from an act' and so fit within the definition of a 'service' in terms of the Sixth Directive. However, the Court ruled:

*'an undertaking given by a farmer under a national compensation scheme not to harvest at least 20% of his potato crop does not constitute a supply of services for the purposes of [the Sixth] Directive.'*¹⁶

33. In the opinion of Advocate General Jacobs, it did not amount to a service. He commented that:

*'any payment, except perhaps a gift, will have conditions attached to it whose performance might, by creative use of language, be described as a service.'*¹⁷

34. *Mohr v. Finanzamt Bad Segeberg* [1996] BVC 293 was another ECJ case in which such a finding was made. In this case, an undertaking by a farmer to refrain from milk production was found not to constitute a supply within the meaning of the Sixth Directive.

¹⁵ Article 6(1) of the Sixth Directive provides that a supply of services means any transaction that does not constitute a supply of goods. It also provides that such transactions could be obligations to refrain from an act or to tolerate an act or situation.

¹⁶ *Landboden* Judgment.

¹⁷ Opinion of Advocate General paragraph 24, *Landboden*.

35. In *Landboden*, it was held that for an undertaking to be covered by the common system of VAT, it must imply consumption¹⁸, and that by undertaking to reduce production the farmer did not provide either services to an identifiable consumer, or some benefit capable of being a cost component of another person in the commercial chain.¹⁹

36. Under the GST Act, there will be no GST on a supply unless it is a 'taxable supply'. It is the concept of a 'supply' itself that is the entry point into the GST system. As supply 'is defined broadly and is intended to encompass supplies as widely as possible'²⁰, we consider that the undertaking to reduce production as dealt with by *Landboden* would be a 'supply' under paragraph 9-10(2)(g). Whether the supply would be a taxable supply would then depend on the requirements of section 9-5 being met in relation to that supply.

Agreement which is binding where the transaction is a supply of a right or obligation

37. For there to be a supply of a surrender of any right or entering into an obligation, such rights or obligations must be binding on the parties. The creation of expectations among the parties does not, in itself, necessarily establish a supply.

38. An agreement that does not bind the parties in some way would not be sufficient to establish a supply by one party to the other unless there is something else, such as goods or some other thing, passing between the parties.

39. This requirement was emphasised by the New Zealand Court of Appeal in *C of IR v. New Zealand Refining Co. Ltd.*²¹ The case concerned payments made by the New Zealand Government to the New Zealand Refining Company that were only to be made on condition that the refinery remained operational.

¹⁸ Judgment, paragraph 20. Article 2 of the First VAT directive (*Directive 67/227/EEC : First Council Directive of the European Economic Community of 11 April 1967 on the harmonisation of legislation of member states concerning turnover taxes*) provides that the common system of value added tax involves the application to goods and services of a general tax on consumption.

¹⁹ Judgment, paragraph 23.

²⁰ Explanatory memorandum, paragraph 3.6.

²¹ *C of IR v. New Zealand Refining Co. Ltd* (1997) 18 NZTC 13187.

Earlier supply

45. Each and every supply is subject to GST provided the supply satisfies the requirements of a taxable supply²⁶. The GST Act does not prescribe any sequencing or hierarchy of supplies for taxing purposes. GST becomes payable on the relevant supply.

46. In these circumstances, where the subject of the dispute is an earlier transaction in which a supply was made involving the parties, that supply is referred to in this ruling as an ‘earlier supply’.

Example – Earlier supply

47. *Widget Company supplies toys to a retailer. A dispute between the parties over payment for the toys is subsequently resolved through an out-of-court settlement, with the retailer paying all monies owed. The supply of the toys, that is the subject of the dispute, is an earlier supply because it occurred before the dispute arose.*

Current supply

48. A new supply may be created by the terms of the settlement. In this Ruling, such a supply is referred to as a ‘current supply’.

Example – Current supply

49. *A dispute arises over a claim by Beaut Enterprises Pty Ltd that Plagiariser Pty Ltd is using their trade name. Negotiations between the parties follow, resulting in Beaut entering into an agreement with Plagiariser that allows Plagiariser to use its trade name in the future. This would constitute the supply of a right under the agreement between Beaut and Plagiariser that amounts to a ‘current’ supply.²⁷*

Supply related to discontinuance of action

50. Even where there is no earlier or current supply, the very wide range of things that can constitute a ‘supply’ means that one or more new supplies will probably crystallise on an out-of-court settlement being reached.

²⁶ Section 9-5.

²⁷ *Cooper Chasney Ltd* (1990) 5 BVC 677.

75. Section 9-15 further provides that a payment will be consideration for a supply if the payment is ‘in connection with’ a supply and ‘in response to’ or ‘for the inducement’ of a supply. Thus, there must be a sufficient nexus between a particular supply and a particular payment, which is provided for that supply, for there to be a supply for consideration.

76. It follows that there are two elements to the definition of consideration. The first is the payment by one entity to another. The second element is the nexus that must be established between the payment and a supply.

77. The definition of consideration in the New Zealand GST Act⁴² is similar to the Australian definition. In *C of IR v. Databank Systems Ltd* (1989) 11 NZTC 6093, at 6102, Richardson J commented that the New Zealand definition of consideration ‘breathed comprehensiveness’.

78. In *New Zealand Refining Co. Ltd v. C of IR* (1995) 17 NZTC 12307, at 12314, Henry J commented that the definition was wide, and that ‘in response to’ and ‘for the inducement of’ added little to ‘in respect of’, given the breadth of the latter term.

79. In Australia, the definition of consideration is similarly wide. To the extent that ‘in connection with’ may be narrower in scope than ‘in respect of’, the phrases ‘in response to’ and ‘for the inducement of’ may assume added stature.

Is the supply made for consideration?

80. The general theme of a ‘supply for consideration’ is as much a cornerstone of the VAT and GST regimes in the UK, NZ and Canada as it is under the GST Act.

⁴² Subsection 2(1) of the *Goods and Services Tax Act 1985* (NZ) Definition:-
“Consideration”, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body.

The need for nexus

81. It will not be sufficient for there to be a supply and a payment. GST is not payable on supplies unless they are made *for* consideration, and the other tests in section 9-5 are satisfied.⁴³ There must be a sufficient nexus between the supply and the payment. In *C of IR v. New Zealand Refining Co. Ltd* (1997) 18 NZTC 13187, at 13193 Blanchard J commented:

‘It can be seen that ... a linkage between supply and consideration is requisite to the imposition of the tax ... There is a practical necessity for a sufficient connection between the payment and the supply. The mechanics of the legislation will otherwise make it impossible to collect the GST.’

The nexus test in Canada and the European Community

82. The Canadian legislation uses the expression ‘consideration for the supply’.⁴⁴ The VAT law in the European Community uses the expression ‘supply effected for consideration’, with no elaboration on what ‘for’ means in this context.⁴⁵ The Courts in the UK have adopted a ‘direct link’ test in determining whether consideration is ‘for’ a supply in those jurisdictions⁴⁶.

The nexus test in New Zealand

83. While European and Canadian authorities demonstrate the need for a link between supply and consideration for a VAT or GST liability to arise, in New Zealand the definition of consideration itself describes the link. The term ‘consideration’ is defined in relation to supplies of goods and services. The definition includes any payment, act or forbearance in respect of, in response to, or for the inducement of, the supply of any goods and services.⁴⁷

⁴³ Paragraph 9-5(a).

⁴⁴ In Canada, tax is payable on ‘the value of the consideration for the supply’ *Excise Tax Act, R.S., c.E-13* subsection 165(1).

⁴⁵ Sixth Directive, Article 2(1).

⁴⁶ See, for example, *Apple and Pear Development Council v Customs and Excise Commissioners* [1988] BTC 5116.

⁴⁷ *Goods and Services Tax Act 1985 (NZ)*, subsection 2(1).

Which supply has the nexus with the consideration?

100. As discussed above, a sufficient nexus between a payment made under a court order or out-of-court settlement and a supply must exist to create the 'supply for consideration' relationship. Our views on where such a relationship exists are set out below.

Earlier supply

101. Where the only supply (other than a 'discontinuance' supply⁶¹) in relation to a court order or out-of-court settlement is an earlier supply and a sufficient nexus exists between the payment made under that order or settlement and the earlier supply, the payment will be consideration for that supply.

Example - payment for an earlier supply

102. *In the Widget Company example at paragraph 47, the out-of-court settlement reached with the retailer provides for the retailer to make payment in full to Widget for the toys. The supply of the toys is an earlier supply and there is a sufficient nexus between it and the payment. The payment is consideration for that supply.*

103. A payment made under a court order or out-of-court settlement may also result in an effective reduction in the price of an earlier supply, perhaps to nil. Where this happens, an adjustment event may be required (refer paragraphs 126 to 136 on GST consequences).

Example - reduction in the price of an earlier supply

104. *The retailer paid Widget Company the full price for the toys, but subsequently discovered they were cheaper toys than it believed it was purchasing. The dispute was settled with Widget agreeing that the price charged was excessive for the toys. The terms of the settlement provided for Widget to pay back to the retailer an amount that reflects the price difference between the two products. The payment will be a reduction in the consideration for the supply.*

Current supply

105. Where the only supply (other than a 'discontinuance' supply) in relation to a court order or out-of-court settlement is a current supply and a sufficient nexus exists between the payment and that supply, the payment will be consideration for the current supply.

⁶¹ Discussion of discontinuance supplies commences at paragraph 50.

Discontinuance supply

106. Where the only supply in relation to an out-of-court settlement is a 'discontinuance' supply, it will typically be because the subject of the dispute is a damages claim. In such a case, the payment under the settlement would be in respect of that claim and not have a sufficient nexus with the discontinuance supply.

107. In most instances, a 'discontinuance' supply will not have a separately ascribed value and will merely be an inherent part of the legal machinery to add finality to a dispute which does not give rise to additional payment in its own right. They are in the nature of a term or condition of the settlement, rather than being the subject of the settlement.

108. We do not consider that the inclusion of a 'no liability' clause in a settlement deed alters this position. 'No liability' clauses are commonly included in settlement agreements and we do not consider their inclusion to alter the substance of the original dispute, or the reason payment is made.

109. We consider that a payment made under a settlement deed may have a nexus with a discontinuance supply only if there is overwhelming evidence that the claim which is the subject of the dispute is so lacking in substance that the payment could only have been made for the discontinuance supply.

Damages

110. With a dispute over a damages claim, the subject of the dispute does not constitute a supply made by the aggrieved party. If a payment made under a court order is wholly in respect of such a claim, the payment will not be consideration for a supply.⁶²

111. If a payment is made under an out-of-court settlement to resolve a damages claim and there is no earlier or current supply, the payment will be treated as payment of the damages claim and will not be consideration for a supply at all, regardless of whether there is an identifiable discontinuance supply under the settlement.

⁶² See discussion about claims where the subject of the claim is not a supply, commencing at paragraph 71.

Example – payment of damages

112. *Bluey's Waste Removal contracts for a three month period with the local Council to collect waste from specified sites in a particular area and remove it to the Council's rubbish tip.*

Subsequently, one of Bluey's trucks has its suspension badly damaged on the tip site while delivering a load of rubbish in accordance with the contract. An obstacle, which should have been removed by Council staff, was the cause of this damage.

113. *Bluey takes legal action to recover \$50,000, being the cost to repair the truck and the loss of productive time caused by the truck being off the road. Subsequently, Bluey and the Council settle the dispute, with the Council paying Bluey \$37,000 and Bluey agreeing to proceed no further with the action.*

114. *No part of the \$37,000 paid by the Council to Bluey is consideration for a supply.'*

Apportionment

115. Where payment made under a court order or out-of-court settlement has a sufficient nexus with more than one supply, with one or more supplies being taxable and one or more being GST-free or input taxed, the payment will be for each of the relevant parts. This will also be the case where the payment is partly for an item of damages which is not a supply.

116. Where a court order (issued in accordance with the court's judgment on the case) itself dissects and itemises the payment into the heads of claim relating to the individual supplies and / or item of damages, that itemisation will be accepted as representing the amounts of these relevant parts.

117. In the case of an out-of-court settlement, where the terms of the settlement include a dissection and itemisation of the payment into the heads of claim, that itemisation will be accepted as representing the amounts of these relevant parts to the extent that it is made on a reasonable basis.

118. Where no dissection is made, even though the payment has a sufficient nexus with more than one supply, or to a supply and an item of damages which is not a supply, the payment should be apportioned into amounts representing these relevant parts in order that the correct GST consequences result.

119. The apportionment should be determined by the parties on a reasonable basis. Where a payment is apportioned in a manner that cannot be justified in terms of reasonableness, the general anti-avoidance provisions of the GST Act⁶³ may have application.

Example – apportionment where no earlier supply

120. *Triple dot, an Australian based provider of music services on the internet, is sued by Ozy Rockers, a local rock group, for infringement of copyright in relation to its material. The infringement relates to similarities between the website signature tune and the music and lyrics of one of the band’s top forty hit tunes. The infringement occurred at the time the website first appeared in October 2000. Since then Triple dot has achieved unparalleled success in attracting ‘surfers’ to the site.*

121. *Ozy Rockers is seeking damages for the infringement in the order of \$50,000. Prior to the matter being considered by the courts Ozy Rockers and Triple dot enter into negotiations in an attempt to resolve the dispute. During the discussions a settlement is reached which provides that Triple dot will make a one off payment of \$200,000 to Ozy Rockers. The payment is for the past infringement and the ongoing right for Triple dot to use the signature tune.*

122. Apportionment is necessary for the correct GST consequences to attach to the supply of the ongoing right to use the copyright. A reasonable approach is required for calculating the necessary apportionment. In the absence of any further information, it may be reasonable to apportion \$50,000 to damages for the breach of contract (which would not attract GST) and \$150,000 to the use of the copyright (a taxable supply). An alternative basis for apportionment may be to use industry standards to calculate copyright fees.

Example - apportionment where an earlier supply

123. *Just before Valentines Day, Flowerbox, a GST registered gift shop, receives a supply of wilted flowers for which it has paid \$5,500 and claimed an input tax credit of \$500. The supplier refuses to refund any part of this amount. Flowerbox sues the supplier for damages, in the amount of \$12,000. Flowerbox has based the amount of its claim on the cost of the flowers (\$5,500) plus an amount of \$6,500 that it asserts is equal to the loss of profits it would have made from the sale of the flowers. The court rules in favour of Flowerbox,*

⁶³ Division 165.

but the total award is reduced to \$9,900. The court does not dissect the amount of the award.

124. *To apportion this amount it is reasonable that \$5,500 is applied to the reduction in the price of the flowers and the balance (\$4,400) to the damages for loss of business. As an alternative, it might be appropriate to use the relative proportions of the original heads of claim as the basis for dissecting the amounts awarded by the court.*

125. *Flowerbox has an increasing adjustment because its previously attributed input tax credit amount is greater than the corrected input tax credit amount as a result of the court award. No GST is payable on the amount for damages for loss of business.*

GST consequences

126. The GST consequences of a payment made under a court order or out-of-court settlement may be:

- (i) attribution of GST payable or input tax credit in the tax period the payment is made⁶⁴; or
- (ii) attribution of increasing or decreasing adjustments in respect of changes to the consideration for a supply⁶⁵; or
- (iii) no attribution or adjustment action required.

Attribution in the period the payment is made

127. Attribution of GST payable or input tax credit in the tax period the settlement payment is made occurs where:

- (i) the payment is consideration for an earlier or current supply; and
- (ii) the supplier or recipient attributes on a cash basis; or
- (iii) no invoice was issued for the supply and no part of the consideration for the supply was provided or received in any previous tax period.

⁶⁴ A more detailed explanation of attribution is contained GSTR 2000/29, which is about attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25.

⁶⁵ A more detailed explanation of adjustment events is contained GSTR 2000/19, which is about making adjustments under Division 19 for adjustment events.

Adjustments because of changes to the consideration for a supply

128. An adjustment is needed where the supplier or recipient attributes on a basis other than cash and:

- (i) the payment is consideration for an earlier supply; and
- (ii) an invoice was issued, or some part of the consideration was received or provided in an earlier tax period; and
- (iii) the payment (together with earlier payments if any) made under the settlement or order differs from the amount of the consideration on which the GST payable and input tax credit were previously attributed.

129. A payment made under a court order or out-of-court settlement may also be a repayment of consideration wholly or in part for an earlier supply. In these cases, an adjustment will also be required (see example at paragraph 104; also see example commencing at paragraph 133).

130. A supplier may have already made a decreasing adjustment in an earlier tax period as a result of all or part of the consideration for the supply being written off as bad, or because it is 12 months or more overdue.⁶⁶

131. Where the whole or part of the consideration for which a decreasing adjustment was previously made is subsequently recovered under a court order or settlement, the supplier will have a resulting increasing adjustment.⁶⁷

No attribution or adjustment action required

132. No attribution or adjustment action is required in respect of a settlement payment made under a court order or out-of-court settlement where:

- (i) the payment is not consideration for a supply; or
- (ii) the payment is consideration for a supply that is GST-free or input taxed; or
- (iii) the payment made (or the payment together with earlier payments, if any, for the supply):
 - is equal to the amount of the consideration on which the GST payable and input tax credit were previously attributed; and

⁶⁶ Division 21 is about bad debts.

⁶⁷ A more detailed explanation of adjustments for the writing off and recovery of bad debts is contained in GSTR 2000/2.

Transition Act, there will be no GST payable and no input tax credit entitlements.

Example – earlier supply before 1 July 2000

140. *Widget Company sold toys to a retailer in May 2000. The dispute over payment is finally resolved by out-of-court settlement in November 2000. There is a sufficient nexus between the payment and the earlier supply. There will be no GST payable or input tax credit entitlement in respect of that supply as it was made prior to 1 July 2000.*

141. A current supply may arise from a court order or out-of-court settlement made either before 1 July 2000 or on or after that date. Where the current supply itself is made on or after 1 July 2000, and there is a sufficient nexus between a payment resulting from the order or settlement and the current supply, the payment will be consideration for the current supply.

Example – current supply on or after 1 July 2000

142. *Beaut Enterprises Pty Ltd and Plagiariser Pty Ltd (see example at paragraph 49) resolve their differences over the wrongful use by Plagiariser of Beaut's trade name. The dispute first arose in May 1999. Under the terms of the settlement, Plagiariser became entitled to use the trade name on 1 August 2000. The current supply is made on or after 1 July 2000, regardless of the date on which settlement is reached.*

143. *Part of the payment made by Plagiariser under the settlement has a sufficient nexus with the current supply. That part of the payment is consideration for the taxable supply. It makes no difference whether the payment was made by Plagiariser before 1 July 2000. The Transition Act provides that any consideration received before 1 July 2000 in connection with a supply made on or after that day is taken to be received in the first tax period after that day.⁶⁹*

144. Flowchart of transitional effects:

⁶⁹ Section 10 of the Transition Act.



Costs

145. When a dispute is finalised, either by a court giving judgment or through negotiation of a settlement, the unsuccessful party in the action may be required to pay the costs or part of the costs that have been incurred by the successful party in bringing or defending the claim. These costs, referred to as party/party costs, could include, barrister’s fees, solicitor’s costs, fees for various expert reports and court costs.

146. In any legal action the parties concerned are required to pay their legal advisers the solicitor client costs⁷⁰ incurred and the supply of these legal services will attract GST and be GST inclusive sums to the extent that they are not GST-free. Both parties to a dispute, as recipients of a supply of legal representation respectively, may be entitled to an input tax credit for a creditable or partly creditable acquisition⁷¹ of these services.

147. For the purposes of this Ruling, we are concerned with the subsequent stage when the successful party is able to recover costs wholly or partly through a court order for costs or by negotiation of an amount in a settlement.

148. As we have seen for a supply to be a taxable supply the conditions under section 9-5 of the GST Act must be met. In the instance of the payment of costs under the court order or settlement there is no supply for consideration from the successful party to the unsuccessful party. This is essentially paying compensation for costs or losses incurred in the dispute and will be treated in the same manner as damages under paragraphs 110 and 111.

149. Accordingly, the payment of court ordered costs or costs negotiated in a settlement in the circumstances described will not be consideration for an earlier or current supply. It does not matter that the payment of the costs order or settled amount is made by an entity other than the unsuccessful party.

Example - Unregistered entity

150. *Matthew, a part-time artist not registered for GST, is sued by another more prominent artist in a defamation action. The matter proceeds to court but the judge dismisses the case against Matthew and costs are awarded in his favour.*

151. *GST would have been included in the fees for the legal representation supplied to Matthew.⁷² However as Matthew is not registered he is unable to claim an input tax credit for the amount of*

⁷⁰ Except in Workers Compensation cases where the applicant's solicitor is generally statute barred from obtaining payment from the applicant and recovers against the defendant/insurer on a party/party basis. The GST consequences associated with the supply of legal services to the applicant are not altered ie, GST is remitted by the applicant's solicitor even though payment is made by the defendant/insurer. The defendant/insurer is not entitled to claim an input tax credit when making this payment.

⁷¹ Section 11-20 and 11-30.

^{71A} [Omitted.]

⁷² Matthew's solicitor is responsible for the GST liability on the supply of legal services to Matthew.

GST included in those fees. Therefore, the actual cost to him is a GST inclusive amount.

152. *The payment of the awarded costs to Matthew is not a payment for any supply made by Matthew. The costs award is compensation for the costs incurred by Matthew in defending the claim brought by the other artist and is treated in the same way as a payment of damages. There is no GST liability for Matthew arising from the receipt of the payment.*

Example - Registered entity

153. *ABC Co, a registered transport company, sues for compensation for damages arising out of breach of a contract it has with a major retailer. Prior to any court proceedings being issued, a settlement is reached whereby the retailer agrees to pay the estimate of damages and a percentage of the costs incurred by ABC Co in bringing the action, for example, for the recovery of dishonoured cheque fees, costs of issuing a letter of demand, or court filing fees etc.*

154. *ABC Co is able to claim an input tax credit for the GST included in the fees charged by its legal representatives.⁷³ The actual cost to ABC Co is a GST exclusive amount.*

155. *As with a court ordered award of costs, the payment of costs to ABC Co under the settlement arrangements is not a payment for a supply made by ABC Co. It is a payment akin to damages and there is no GST liability for ABC Co arising from the receipt of the payment.*

Detailed contents list

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⁷³ ABC Co's solicitor is responsible for the GST liability on the supply of legal services to ABC Co.

^{73A} [Omitted.]

- Excise Tax Act 85 (Canada) 165(1)
- Goods and Services Tax Act 85 (NZ) 2(1)
- Goods and Services Tax Act 85 (NZ) 5(1)
- Goods and Services Tax Act 85 (NZ) 8
- TAA 1953 Sch 1 Div 358

Case references:

- Apple and Pear Development Council v. Customs and Excise Commissioners [1988] BTC 5116
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Appendix 1: Overview

Appendix 2: How to categorise a supply



