PS LA 2005/11 (Withdrawn) - Application of Goods and Services Tax to costs awarded by courts or settled by agreement

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This practice statement is withdrawn with effect from 28 August 2007. It has been replaced by PS LA 2009/9.

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Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2005/11

This practice statement is withdrawn with effect from 28 August 2007. It has been replaced by PS LA 2009/9.

FOI status: may be released

This Practice Statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by Tax officers unless doing so creates unintended consequences. Where this occurs officers must follow their Business Line's escalation process.

SUBJECT: **Application of Goods and Services Tax to costs awarded by courts or settled by agreement**

PURPOSE: **To ensure Tax Office staff are:**

- **aware of the correct application of the Goods and Services Tax (GST) to legal costs, and**
- **applying the correct procedure**

when making a legal costs payment or submitting a schedule of legal costs to receive payment.

STATEMENT

1. When the Tax Office is:

   - making a legal costs payment, or
   - formulating a schedule of legal expenses to receive payment of costs

   either as a result of a court order or a negotiated settlement of the costs amount, the legal costs must be:

   - the **GST exclusive** amounts, in all cases where the successful party is entitled to claim an input tax credit in full
   - the **GST exclusive amounts plus the proportion of input tax credit not entitled to be claimed,** in all cases where the successful party is only entitled to claim a proportion of the input tax credit[1]
   - the **GST inclusive** amounts in all cases where the successful party is not entitled to claim to any input tax credit.

[1] The other party would not be entitled to claim an input tax credit if they were not registered for GST or the matter was not related to carrying on their enterprise or otherwise not for a creditable purpose.

EXPLANATION

2. This Practice Statement deals with the GST implications of the legal costs awarded by courts or settled by agreement between the parties out of court.

Background

3. A legal dispute is generally finalised either by a court providing a judgment or by a negotiated settlement between the parties. The unsuccessful party is generally required to pay the legal costs that have been incurred by the successful party. These legal costs can be party - party, solicitor - client, indemnity costs or a negotiated amount.

4. The types of legal costs that are likely to be incurred by a party to a legal dispute include:

- solicitor's fees
- barrister's fees
- expert witness fees
- costs of expert witness reports
- legal administration fees (copying, courier, postage, etc)
- filing fees
- court costs
- search fees (eg Land Title Office searches & Australian Securities and Investment Commission (ASIC) searches)
- advertising fees
- service fees, and
- other disbursements such as travel and accommodation.

GST consequences of legal services provided to parties in legal dispute

5. It is important to note that each of these legal costs incurred will have a GST consequence. The GST consequence will depend on whether the resulting payment constitutes consideration for a supply and, if so, whether the supply is in the nature of a taxable, input taxed or GST-free supply. Generally, the GST consequences of the legal services listed in paragraph 4 above are as follows:

• solicitor's fees	*GST applies*
• barrister's fees	*GST applies*
• expert witness fees	*GST applies*
• costs of expert witness reports	*GST applies*
• legal administration fees	*GST applies*
• filing fees	*No GST*
• court costs	*No GST*

- search fees (Land Title Office & ASIC) *GST applies*[2]
- advertising fees *GST applies*
- service fees *GST applies*
- travel and accommodation. *GST applies*

6. Both parties to a legal dispute, in receipt of the supply of these types of legal services to which GST applies, may be entitled to an input tax credit for a creditable acquisition of those services.

7. Where the Tax Office is a party to a legal dispute and is supplied with a legal service, such as a barrister to perform the counsel function, that barrister is required to provide the Tax Office with a tax invoice where GST is charged. The Tax Office in turn is entitled to claim an input tax credit for the amount of GST charged by the barrister.

GST consequences of costs awarded by courts or negotiated after dispute is finalised

8. The payment of legal costs to the successful party under a court order or negotiated amount is not consideration for a supply[3]. It is to compensate a party for the legal costs incurred in the dispute and, for GST purposes it is treated in the same way as payment of damages. GST does not apply.

9. However, the legal costs ordered by a court or the negotiated cost amount must take account of any entitlement to an input tax credit of the parties to the original supply. In this regard, if a taxpayer is registered for GST they will be entitled to claim an input tax credit unless the legal costs do not relate to carrying on their enterprise or relate to making input taxed supplies or are of a private or domestic nature[4]. It is therefore very important that when the successful party to a legal dispute is recovering its legal costs, the combined GST consequences are clearly understood and applied appropriately.

Example 1

10. Taxpayer is registered for GST.
    - Taxpayer is successful in the litigation (and the exclusions referred to in paragraph 9 above do not apply).
    - Taxpayer's solicitor renders a bill to the taxpayer for $980 being:
      - Court fees $100 (no GST)
      - Search fees $220 (includes $20 GST as searches conducted by the solicitor)
      - Solicitor's fees $660 (includes $60 GST)

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[2] Note: GST only applies if, as is customary the searches are outsourced or conducted through an intermediary entity such as Australian Business Research Pty Ltd (ABR) or CITEC. If the searches are performed directly with either ASIC or the Land Titles Office there will be no GST.

[3] See paragraph 148 of GSTR 2001/4.

[4] Sections 11-5 and 11-15 of *A New Tax System* (*Goods and Services Tax) Act 1999*.

- As the taxpayer is entitled to an input tax credit of $80 the correct amount of legal costs payable by the Tax Office is $900[5].

Example 2

11. Taxpayer is not registered for GST, or the costs are not incurred in the carrying on of their enterprise, or are of a domestic or private nature, or relate to making input taxed supplies.

    - Taxpayer is successful in the litigation
    - Taxpayer's solicitor renders a bill to the taxpayer for $980 being:
        - Court fees $100 (no GST)
        - Search fees $220 (includes $20 GST as searches conducted by the solicitor)
        - Solicitor's fees $660 (includes $60 GST)
    - As the taxpayer is **not** entitled to an input tax credit of $80 the correct amount of legal costs payable by the Tax Office is $980.

    It is only where the successful party to a legal action is not entitled to claim the input tax credits associated with the costs of the action that the GST amount should be included in the final legal costs amount.

Procedure to be followed by Tax Office staff

When the Tax Office makes a payment of legal costs

12. Prior to the Tax Office making a payment of the legal costs, the other party must forward details of the legal expenses it has incurred and is claiming for payment. The invoices must be of sufficient detail to identify how they were determined, whether GST applied, whether the party was entitled to claim an input tax credit and if so, to what extent. If the invoices do not give sufficient details then they should be queried and further details requested in respect of the GST application and payment. Upon satisfaction that the GST component of the invoices has not been included by the party if they are registered and entitled to claim an input tax credit, and that the legal expenses claimed are reasonable given the nature and complexity of the matter, then payment of the legal costs should be made. It is important to note however that when the Tax Office pays the costs of an unregistered taxpayer or a registered taxpayer who is not entitled to claim input tax credits on the legal costs, it is the GST inclusive amount which is to be reimbursed.

When the Tax Office submits a schedule of legal expenses for payment of costs

13. Where the Tax Office is to receive a payment of legal costs it must prepare a schedule of legal expenses incurred to enable determination of the amount of legal costs to be paid by the other party. The schedule must contain invoices with sufficient detail to determine whether GST was applied. If so, the GST paid is not a cost to the Tax Office as it is able to claim an input tax credit for that amount, and the expense the Tax Office is seeking to recover must be the GST exclusive amount on the invoice.

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[5] In the event that the taxpayer did not pay the solicitor his bill for $980 then the solicitor would recover $900 from the Tax Office when the Tax Office paid the costs. The solicitor will need to take recovery action against his client to recover the remaining $80.

14. There are also less complex legal proceedings where there may be no need for the Tax Office to prepare a schedule of legal expenses, but nevertheless, the same policy applies. Where, for example an Operations officer obtains a default judgment on a summons issued for a tax liability, the only legal expenses likely to be incurred by the Tax Office would be filing fees (no GST applied) and service fees (GST applied). In this situation the Operations officer should seek from the court the costs for the filing fee and the service fee exclusive of the GST amount. As the Tax Office is registered for GST it is entitled to claim an input tax credit for the GST amount on the service fee.

When the Tax Office negotiates a settlement of the legal costs amount

15. A negotiated settlement of legal costs of a matter generally occurs on settlement of a dispute and can occur prior to, during or after litigation. Irrespective of which point in time the negotiated settlement of the legal costs issue occurs, the Tax officers involved must ensure that a schedule of legal expenses incurred to that point is prepared by the party to receive the payment and must identify whether the GST has been applied correctly in order for the correct determination of the final GST exclusive legal costs amount to be made. In those instances where the other party is not entitled to claim input tax credits in relation to the legal costs the amount of the payment would need to be GST inclusive.

Where the Australian Government Solicitor (AGS) is engaged

16. Where the AGS has acted on the Tax Office's behalf in respect of a matter, AGS will deal with the legal costs. AGS will discuss any issues that may arise with the Legal Services Branch case officer. It is important in this arrangement that instructions to AGS must clearly specify the correct position of GST law and the policy of the Tax Office in respect of the GST implications on legal costs orders and payments.

The Tax Office must be the 'model taxpayer'

17. The Tax Office as the administrator of the Commonwealth taxation laws must act as the 'model taxpayer' and must be seen to be fully compliant with all aspects of taxation law related legislation. The Tax Office must also act as a Model Litigant in accordance with the Legal Services Directions of the Attorney-General. To over claim or overpay legal costs through the misapplication of the GST law would adversely affect the integrity and public confidence of the Tax Office's administration of taxation laws. It is therefore imperative that the Tax Office correctly applies the GST laws to legal costs calculations for payment and recovery, either by court order or negotiated settlement.

Who does this apply to in the Tax Office?

18. There are various areas in the Tax Office that may have direct involvement in dealing with legal costs orders, including:

- Legal Services Branch
- Business Line litigation liaison officers
- Business Line officers involved in negotiating settlement of disputes
- Operations, and
- In House Prosecutions.

There are also areas of the Tax Office that provide advice in litigation and settlement matters, such as:

- Tax Counsel Network
- Business Line technical advisors, and
- Centres of Expertise.

All should be aware of and understand this policy and these procedures. Where other Tax Office employees encounter legal costs payment issues, they must contact the Legal Services Branch in their respective region for advice on the application of the Tax Office policy.

Financial Management and Accountability Act 1997

19. Where the Tax Office is awarded legal costs against another party it has a duty under the *Financial Management and Accountability Act 1997* to seek to recover the legal costs. Where AGS and external counsel are engaged and acting in a matter, they should be clearly instructed in respect of this obligation to seek to recover the legal costs.

subject references	AGS Costs GST on costs Schedule of Costs Settlement of Costs
legislative references	*Financial Management & Accountability Act 1997* *A New Tax System (Goods and Services Tax) Act 1999*
related public rulings	GSTR 2001/4; GSTR 2000/37
related practice statements	PSLA 2002/2
case references	
file references	04/16847

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Other Business Lines consulted	**GST and OCTC**