

GST ON JUDGMENTS AND OUT OF COURT SETTLEMENTS

LIFE AFTER *QANTAS* AND *MBI PROPERTIES*¹

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INTRODUCTION

In 2001 the Commissioner released [GST Ruling GSTR 2001/4](#) “Goods and services tax: GST consequences of court orders and out-of-court settlements” (**the Ruling**). The Ruling outlines the Commissioner’s views on the treatment of court orders and out of court settlements under the *A New Tax System (Goods and Services Tax) Act 1999* (**the GST Act**).² Given that there were only a handful of authorities at the time dealing with GST, the Ruling was comparatively short and was based around some fundamental principles, including the following:

- The need to find a relevant nexus between the payment and a supply³ made pursuant to a court judgment or a settlement agreement for there to be a taxable supply.⁴
- A payment in respect of damages will not constitute consideration for a supply.
- The mere existence of releases by the party receiving the payment (referred to as “discontinuance supplies”) to give effect to a settlement of a claim for damages will generally not give rise to a taxable supply.

Fifteen years have passed since the Ruling was released. During that time there has been a number of decisions of the Courts (both State and Federal) dealing with the impact of GST on judgments, damages and costs. Further, the High Court has on three occasions considered the concepts of “supply” and “consideration” and the requisite nexus between the two, on each occasion giving the concepts a very broad scope of operation.

In light of these decisions, it is appropriate to assess the continued relevance of the Ruling to court judgments and the entry of parties into contractual arrangements to resolve disputes.

This paper provides a summary of the Ruling and outlines its essential principles. These principles are then considered in light of a number of authorities dealing with the GST treatment of judgments, damages and legal costs that were

¹ This paper is an update to my paper published in the Australian GST Journal in April 2013, “GST on judgments and out of court settlements: Is GSTR 2001/4 still relevant?”

² In this paper all statutory references are to the GST Act unless stated otherwise.

³ As defined in s 9-10.

⁴ As defined in s 9-5.

handed down before the decision of the High Court in *Qantas*. On the whole, I consider that the principles in the Ruling have stood up pretty well.

However, given the observations of the High Court in *Commissioner of Taxation v Qantas Airways Ltd* [2012] HCA; (2012) 291 ALR 653 (*Qantas*) and *Commissioner of Taxation v MBI Properties* [2014] HCA 49 (*MBI Properties*) about the breadth of the concept of “supply” and the nexus between “supply” and “consideration”, I have found it necessary to revisit the Ruling.

In doing so, I have focused on two issues.

First, whether a “discontinuance supply” is to be regarded as a taxable supply where parties enter into terms of settlement. In my view, the principles stated in the Ruling remain relevant, although this does require the observations of the High Court in *Qantas* and *MBI Properties* to be seen through the lens provided by the majority of the Full Federal Court in *AP Group Limited v Commissioner of Taxation* (2013) 214 FCR 301 (*AP Group*) – namely, that:

- the words “supply for consideration” in s 9-5(a) identify the character of the nexus between “supply” and “consideration”; and
- not every “connection” between an act or event which constitutes a supply and the receipt of consideration will give rise to a taxable supply.

Second, whether an “involuntary supply” by one party is to be regarded as a taxable supply where ownership of property is vested in another entity as a legal consequence of the action. In my view, the observations of the High Court do not impact on the view of the Federal Court (and the Commissioner) that there will be no taxable supply where the owner of the property does not take any positive action.

THE LEGISLATIVE SCHEME

Section 7-1(1) provides that “GST is payable on *taxable supplies and *taxable importations”.

Section 9-5 relevantly defines a “taxable supply” as follows:

You make a **taxable supply** if:

- (a) you make the supply for *consideration;
- (b) ...

However, the supply is not a *taxable supply to the extent that it is *GST-free or *input taxed.

The element of “taxable supply” in paragraph (a) of s 9-5 involves a composite expression, including both “supply” and “consideration”. However, it is not enough that a supply and consideration can be identified. The paragraph will only be satisfied where a sufficient connection between the two can be identified – the supply must be “for” the consideration.

GSTR 2001/4

The focus of the Ruling is on judgments of a court and settlement agreements between the parties – both of which resolve the dispute between the parties. Out of court settlements include any form of dispute resolution where the terms are agreed between the parties.

The Ruling analyses the concept of “supply” and the “nexus” that must exist between the payment and a supply in order to establish the relationship of a “supply for consideration” within s 9-5(a).⁵

Out of court settlements and supplies

Noting that the statutory definition of “supply” is very broad, the Ruling states that in the context of an out of court settlement, a supply referred to under any of the paragraphs within subsection 9-10(2) could be related to an out of court settlement.⁶ The Ruling groups these supplies into three categories, being “earlier supply”, “current supply” and “discontinuance supply”.

Earlier supply

An “earlier supply” will exist where the subject of the dispute is an earlier transaction in which a supply was made involving the parties. The Ruling refers to the following example of an “earlier supply”:⁷

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, being the subject of the dispute, is an earlier supply because it occurred before the dispute arose.

Current supply

A “current supply” is one that it is created by the terms of settlement. The Ruling refers to the following example of a “current supply”:⁸

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. The supply of the right to use the trade name is a ‘current’ supply.

Discontinuance supply

The Ruling observes that terms of settlement will generally provide for the plaintiff to

⁵ For the purposes of this paper I have assumed that all of the other elements of “taxable supply” in s 9-5 of the GST Act are satisfied and also that the supplies area not otherwise GST-free or input taxed.

⁶ At [42].

⁷ At [47].

⁸ At [49].

release the defendant from some or all of the existing claims provided the terms of settlement are complied with. Where a dispute involves court proceedings, the terms of settlement may provide for each party to release the other from such claims and obligations. Also, where proceedings have been commenced, a notice of discontinuance may need to be filed with the Court.

The Ruling considers that the types of supplies which may be created under these conditions of settlement may be characterised as:⁹

- Surrendering a right to pursue further legal action [paragraph 9-10(2)(e)].
- Entering into an obligation to refrain from further legal action [paragraph 9-10(2)(g)].
- Releasing another party from further obligations in relation to the dispute [paragraph 9-10(2)(g)].

These supplies are referred to in the Ruling as “discontinuance supplies”.

Damages

The Ruling takes the view that a number of disputes relate to matters which do not constitute a supply, being claims for damages arising out of the following:

- property damage;
- negligence causing loss of profits;
- wrongful use of trade names;
- breach of copyright;
- termination or breach of contract; and
- personal injury.

The basis for this view is found at [73], which provides as follows:

The most common form of remedy is a claim for damages arising out of the termination or breach of a contract or for some wrong or injury suffered. This damage, loss or injury, being the substance of the dispute, cannot in itself be characterised as a supply made by the aggrieved party. This is because the damage, loss, or injury, in itself does not constitute a supply under section 9-10 of the GST Act.

Court orders and supplies

The focus of the Ruling is on the GST treatment of payments made in compliance with orders of a Court.

The Commissioner does not consider that a court, in giving judgment, makes a supply for GST purposes. Further, the extinguishment of a judgment debt by its payment does not constitute a supply by the judgment creditor. The Commissioner refers to with approval the decisions *Interchase Corporation Ltd v ACN 010 087 573 Pty Ltd*

⁹ At [54].

and Ors [2000] QSC 013 per White J; *Shaw v Director of Housing and State of Tasmania (No 2)* [2001] TASSC 2; (2001) 10 Tas R 1 per Underwood J and *Walter Construction Group Limited v Walker Corporation Ltd & Ors* [2001] NSWSC 283; (2001) 47 ATR 48 per Hunter J.¹⁰

However, the Commissioner considers that:¹¹

- an earlier supply may be the subject of dispute resolved by a Court;
- a current supply may arise as a result of a court order; and
- there will be no discontinuance supply in relation to a dispute resolved by a court order. This is because the terms of the resolution of the dispute are imposed by the Court, and not reached by agreement between the parties.

Costs

The Commissioner considers that the payment of costs as part of a terms of settlement is not consideration for an earlier supply or a current supply.

However, any costs amount should take into account any entitlement to an input tax credit that the other side may have. Of course, this will only be relevant where the party concerned is registered for GST or required to be registered.

Consideration and the search for a “nexus”

The Ruling states that it is not sufficient that there be a supply and a payment. In this context, the Ruling considers that the effect of subsection 9-15(2A)¹² is that the fact that a payment is made in compliance with a court order, or with a settlement relating to proceedings before a Court will not, without more, prevent it from being consideration for a supply.¹³

The Ruling considers that GST is not payable unless there is a supply “for” consideration, ie, there must be a sufficient nexus between the supply and the payment. The Commissioner takes a broad approach to the nexus test as shown at [90] which states as follows:

The Commissioner considers that, in the context of the GST Act, the expression ‘you make the supply for consideration’ in paragraph 9-5(a) means the same as ‘there is consideration for the supply you make’.

¹⁰ At [56]-[67].

¹¹ At [68]-[70].

¹² Subsection 9-15(2A) states:

It does not matter:

(a) whether the payment, act or forbearance was in compliance with an order of a court, or of a tribunal or other body that has the power to make orders; or

(b) whether the payment, act or forbearance was in compliance with a settlement relating to proceedings before a court, or before a tribunal or other body that has the power to make orders.

¹³ At [97].

In the context of out of court settlements and court orders, the Ruling looks at whether there is a nexus between the payment and one or more of the categories of “supplies” referred to above.

Earlier supply

Where the only supply (other than a discontinuance supply) in relation to terms of settlement or a court order is an earlier supply, and there is a sufficient nexus between the payment made and that supply, the payment will be consideration for the supply.

Current supply

Where the only supply (other than a discontinuance supply) in relation to terms of settlement is a current supply, and there is a sufficient nexus between the compensation paid under the settlement and that supply, the compensation will be regarded as consideration for the supply.

Discontinuance supply

The Ruling observes that in most cases, the “discontinuance supply” will have no separately ascribed value and will merely be an inherent part of the legal machinery to add finality to the dispute. The Commissioner’s view is that a “discontinuance supply” is in the nature of a term or condition of the settlement, rather than the subject of the settlement. In this context, every settlement agreement will usually contain at least one “discontinuance supply”.

The Ruling considers that most cases where the only supply is a “discontinuance supply” will involve the settlement of a claim for damages. In that context, the Commissioner’s view is that the payment will be treated as a payment of damages and will not be consideration for a supply at all, regardless of whether there is an identifiable discontinuance supply under the settlement.

The Ruling does leave some room to apply GST to a ‘discontinuance supply’, but 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”.¹⁴

Application of the principles in subsequent rulings

GSTR 2003/11

The principles in the Ruling under-pin the views of the Commissioner in GSTR 2003/11 “Goods and services tax: payment on early termination of a lease of goods”. The views of the Commissioner include:

- In the context of early termination by agreement, a payment may change the consideration for the earlier supply of the goods or be made in connection with other current or earlier supplies.¹⁵

¹⁴ At [109].

¹⁵ See [27]-[37] and [38]-[50].

- In the context of early termination following default by the lessee, the lease may require payment to be made by the lessee to the lessor for any damage or loss suffered because of the early termination. Where that payment is for agreed damages for loss, which has no connection with an earlier or current supply, the payment is not consideration for a supply.¹⁶

GSTR 2009/3

The principles in the Ruling dealing with damages form the basis of the views of the Commissioner in GSTR 2009/3 “Goods and services tax: cancellation fees” dealing with whether a cancellation fee is a payment of liquidated damages, and therefore not consideration for a supply. The Commissioner’s view is as follows ([64]-[66]) (footnotes omitted):

64...The fact that an amount paid in relation to a cancelled arrangement might be described as ‘damages’, a ‘penalty’ or ‘compensation’ does not mean that the amount is not thereby consideration for a supply. An amount can have both the character of damages, a penalty or compensation and also be consideration in connection with a supply.

65. Regardless of whether an amount paid or payable is damages as properly understood (whether it is paid or payable under a liquidated or agreed damages clause or otherwise), the fundamental question to be answered in an Australian GST context is whether the amount is consideration for a supply. The classification of an amount as consideration for a supply or as damages is to be made in accordance with Goods and Services Tax Ruling GSTR 2001/4 Goods and services tax: GST consequences of court orders and out-of-court settlements.

66. GSTR 2001/4 sets out the Commissioner’s views on when damages are, and are not, consideration for a supply. The Commissioner takes the view that payments that are called ‘damages’ resulting from court orders and out-of-court settlements need to be examined to establish whether the payment relates to a supply.

A REVIEW OF THE CASES

GST and judgments

There have been a number of decisions of State and Federal Courts dealing with the impact of GST on the following issues:

- The calculation of damages;
- Whether damages are subject to GST; and
- Costs orders.

These decisions are considered below, in chronological order. The principles outlined in the Ruling generally appear to have stood up well.

[*Vrkic v Otta International*](#) [2003] NSWSC 641 (costs)

Costs were awarded against the second defendant who submitted that the costs order should exclude GST charged by the barrister to the first defendant because the

¹⁶ See [80].

defendant would be entitled to an input tax credit. The Court did not accept the submission, essentially on the basis that there was no evidence that the first defendant would be entitled to an input tax credit. In coming to this view, Campbell J made the following observations (at [25]):

An order for costs is intended to provide an indemnity, or partial indemnity. There is no evidence as to whether the first defendant is a company which would be entitled to receive any benefit from any input tax credit. Without such evidence, there is no reason to cut down what would ordinarily be the full measure of the indemnity.

This decision is consistent with the view of the Commissioner in the Ruling that costs orders should take into account any entitlement to an input tax credit that the other side may have.

[*Bennett v Goodwin*](#) [2005] NSWSC 930; 62 ATR 515 (damages on conversion of goods)

This case involved a claim for damages for conversion. The plaintiff sold the defendant's goods which were located on the plaintiff's property and offset the proceeds against a debt owed by the defendant to the plaintiff. The defendant claimed that the plaintiff sold the goods at less than market value and was entitled to a greater credit against the debt.

One of the goods was sold by the plaintiff for \$10,000, of which \$9,091 was retained after the plaintiff paid GST. The Court awarded damages of \$10,000 (being the market value of the goods) notwithstanding that the plaintiff only received \$9,091. This was because function of damages for conversion is compensatory and it is the price *to the purchaser* which is the appropriate measure of damages. The Court also referred to the view in England that purchase tax payable in connection with the sale of an item ought properly be included in the market value of an item when assessing damages for the conversion of that item: *Martin v London County Council* [1947] KB 628.

The Court did not deal with the relevance (if any) of the purchaser being entitled to claim input tax credits with respect to the GST on the purchase price.

[*Keen v Telstra Corporation Limited*](#) [2006] FCA 834; 153 FCR 28 (costs)

The applicant submitted that Order 62 Rule 12(1) of the *Federal Court Rules* should be construed so as to permit the taxing officer to add, as a disbursement, the GST which the plaintiff had to pay to her solicitors. The applicant effectively asked that the scale of costs be "grossed up" for GST.

The Federal Court noted that there was no provision in the *Federal Court Rules* which allowed GST to be added to the costs allowed under the rule and the provisions. The Court compared this to the position in Tasmania where the rules permit the Supreme Court to allow in a bill of costs an amount referable to GST.¹⁷ This rule was considered in *Thornton v Apollo Nominees Pty Limited* (2005) 59 ATR 244 by Evans J.

¹⁷ Supreme Court Rules 2000 (Tasmania) r 837A.

The Court found that the provisions of the rules were quite clear. In their natural meaning, the rules provided that the only amounts allowable were those fees set out in the schedule. Further, the fees set out in the rules necessarily represented the “price”, for the purpose of both the rules and the GST Act, and therefore included GST as part of the price. In this context, the Court referred to the Explanatory Statement to the rules¹⁸ which noted that the costs were increased by 9.5% ‘on account of the goods and services tax’.

The Court did note the possible injustice of making the costs GST-inclusive, given that a person (as in the present applicant) who was not entitled to input tax credits would be worse off than a business when recovering costs of litigation.

[*Hennessey Glass and Aluminum Pty Ltd v Watpac Australia Pty Ltd*](#) [2007] QDC 57; (2007) 69 ATR 374 (costs)

This proceeding involved review of an assessment of costs made by a Senior Deputy Registrar. The plaintiff contended that the registrar erred in reducing the assessment by 1/11th on the basis that this represented the GST component of costs and the order needed to reflect the fact that the plaintiff was entitled to an input tax credit for the GST paid by its professional costs and outgoings.

The Queensland District Court had issues with the approach of the registrar to make a "sweeping application" of a 1/11th reduction to the assessment. This included the fact that some of the fees were not subject to GST (e.g. filing fees) and that the professional costs were allowed and claimed in accordance with the relevant Scale of Costs. The Court came to the conclusion that the operation of the GST system and the input tax credit system is not a basis for reducing the scale amounts for professional costs.

Nevertheless, referring to the indemnity principle, the Court found that it was reasonable to refer to particular outlays, being the approach of Master Wood in *Merringtons Pty Ltd v Luxottica Retail Australia Pty Ltd* (Unreported, Supreme Court of Victoria, 16 June 2000). Under that approach, where GST has been passed on and claimed as an input tax credit, the amount recovered under an assessment on a standard basis should be the amount of the outlays net of GST. The Court concluded that the registrar ought to have reduced the assessment by 1/11th for outlays (being payments other than solicitors’ professional fees) in which GST had been paid – being all the outlays save for filing fees.

[*ChongHerr Investments Ltd v Titan Sandstone Pty Ltd*](#) [2007] QCA 278 (costs)

As part of submissions by the parties as to costs, the respondent claimed that the appellant’s costs should be reduced by an input tax credit applicable to the professional costs incurred by the appellant.

The Queensland Court of Appeal (at [9]) agreed with the views of the Queensland District Court in *Hennessey Glass* and found that the necessity to give credit for an

¹⁸ Explanatory statement for the *Federal Court Amendment Rules 2000 (No 6)* (Statutory Rule 2000 No 300).

input tax credit applied not to solicitors' professional fees, but that it did apply to outlays which attracted GST.

[Moraghan v Cospak Pty Ltd](#) [2007] VSC 483 (GST on damages)

This case involved a claim for damages with respect to a contract for the purchase and delivery of wine. Cross-claims were filed by the appellant and the respondent. One of the issues was whether the judgment for damages attracted GST and whether the judgment ought to have been exclusive of GST.

The Victorian Supreme Court found that the damages award to the respondent should include GST and in doing so, appeared to accept the submissions of the claimant that GST should be included because the claim was for goods sold and delivered under a term obliging the purchaser to pay GST and the invoiced amounts that make up the respondent's claim were inclusive of GST. Lasry J observed that (at [51]) "*...in a case such as this where a court is involved in determining the commercial relationship between the parties and GST is part of that commercial relationship, then GST was correctly included in the order...*".

The Court treated the damages as consideration for the "earlier supply" of the wine, and therefore consideration for a taxable supply. This can be compared to the finding of the Court that the damages award to the appellant should exclude GST because the claim was in the nature of a damages claim rather than the supply of goods or services.

[Adamson v Ede](#) [2008] NSWSC 767 (damages)

This was an appeal against the order of a Magistrate to award the amounts of \$13,408 and \$4,752 to the plaintiff. The amounts included GST of \$1,128 and \$432 respectively. The amounts were awarded on a *quantum meruit* basis in respect of services provided by the plaintiff to the defendant.

The New South Wales Supreme Court found that the GST was properly included. The plaintiff was not an employee of the defendant and accordingly the services were subject to GST as a taxable supply. The damages award appears to have been treated as consideration for the "earlier supply" by the plaintiff of services.

[Nemeth v Prynew Piling Pty Ltd](#) [2009] NSWSC 511 (damages)

An issue in this case was whether GST should be included in the judgment given against the defendants. The damages related to rectification costs incurred by the plaintiffs on their private residence and the plaintiffs submitted that they would not be entitled to claim input tax credits for the GST on those costs so the damages should include GST. The New South Wales Supreme Court found that the judgment should include GST.

The approach of the Court was consistent with the aim of damages being to provide compensation which is to, so far as money can do, put the party in the same position as he or she would have been in if the contract had been performed or the tort had not

been committed.¹⁹

The Beach Retreat Pty Ltd v Mooloolaba Yacht Club Marina Ltd [2009] QSC 84; [2009] 2 Qd R 356 (costs)

This case involved an application by the defendant for fixed costs on an indemnity basis plus an amount for GST. It was agreed between the parties that each of the applicants was entitled to input tax credits and that the assessed indemnity costs were less than the actual costs paid, even if 10% was added to the assessed figure.

The Court did not accept the "misconceived" submission of the defendant that the reasoning in *ChongHerr Investments* and *Hennessey Glass* required the Court to add an amount which equated to notional GST on the professional costs. As each of the defendants were entitled to an input tax credit for the GST each of them paid, the Court found that it was appropriate to ignore GST on indemnity costs. In coming to this conclusion, the Court was fortified by the Practice Statement issued by the Commissioner.²⁰

Gagner Pty Ltd trading as Indochine Cafe v Canturi Corporation Pty Ltd [2009] NSWCA 413; (2009) 236 FLR 401; (2009) 262 ALR 691 (damages)

This case involved a negligence claim by the respondent against the appellant for damage caused by water flowing into the respondent's shop from the appellant's shop. The trial judge found that the escape of water was caused by the negligence of people for whom the appellant was vicariously liable. The appeal related to the measure of damages payable by the appellant to the respondent.

The New South Wales Court of Appeal (at [134] per Campbell JA (Macfarlane and Sackville AJA agreed)) accepted the appellant's argument that while the respondent might have to pay GST on the goods and services it acquired to make good the damage to the premises, it would be able to recover those amounts by way of input tax credits. Thus, the GST component would not ultimately be a loss and it was wrong to include that component in the award of damages.

Campbell JA (at [149]) referred to a number of authorities where awards of damages for a tort included GST on the individual items that made up the quantum (referring *inter alia* to *Bennett v Goodwin*, *Nemeth v Prynew Pty Ltd* and *Vrkic v Otta International* discussed above). However, the Court observed it was important that in each of those cases the recipient of the damages or the beneficiary of the costs order was not registered for GST and therefore not entitled to any input tax credit. In those circumstances there would be a net loss including the GST paid.

His Honour (at [151]) stated the following principle:

In summary, as the GST legislation currently stands, if the plaintiff in an action for

¹⁹ See GSTR 2003/11 referring to *Haines v Bendall* (1991) 172 CLR 60 per Mason CJ, Dawson, Toohey and Gaudron JJ at 63.

²⁰ Practice Statement LA 2008/16 "The GST implications in the Recovery of Legal Costs (Professional Fees and Disbursements) Awarded by Courts or Settled by Agreement between the Parties". This practice statement is discussed below.

tort is registered for GST purposes, and stands to receive an input tax credit for any GST payments incurred in making good its damage, and there is no impediment to the plaintiff receiving the full benefit of the input tax credit, that GST amount should be excluded from the quantum of damages recoverable.

The respondent, in the alternative, contended that the damages award itself would be subject to GST. The Court did not accept this argument. In coming to this finding, Campbell JA referred to the Ruling with approval (at [157]-[158]):

157 An essential prerequisite for there being an obligation to pay GST concerning (relevantly for present purposes) a supply of goods or services is that there is a “taxable supply”. Under section 9-5 GST Act, an essential prerequisite of there being a “taxable supply” is that “you make the supply for consideration”. The Australian Taxation Office has issued a public ruling, GSTR 2001/4 concerning the GST consequences of court orders and out-of-court settlements. It states, at para [60], that “a court, in giving judgment, does not make a supply for GST purposes.” Nor is there any relevant “taxable supply” involved in the events that led to litigation such as the present. At [71]-[73] the ruling considers situations, including “claims for damages arising out of property damage” and concludes:

“This damage, loss or injury, being the substance of the dispute, cannot in itself be characterised as a supply made by the aggrieved party. This is because the damage, loss or injury, in itself does not constitute a supply under section 9-10 of the GST Act.”

158 Nor would a judgment in the present case, of itself, generate a liability for GST. The ruling says, at [61]:

“The payment, in money, of a judgment debt will not of itself be a supply for GST purposes. It is excluded from being a supply under subsection 9-10(4).

[*Peet Limited v Richmond \(No 2\)*](#) [2009] VSC 585; 76 ATR 644 (damages)

In an earlier judgment, the Victorian Supreme Court determined that the plaintiff was entitled to recover certain amounts from the defendant by way of *quantum meruit*. The plaintiff sought an order grossing up the amount of the damages award by 10%, to allow for GST. Alternatively, an order was sought whereby the defendant would indemnify the plaintiff for any GST it may be found liable to pay on the judgment sum. The basis of the plaintiff’s claim was that unless the judgment took into account its liability to pay GST, its award would be diminished and it would receive 1/11th less than the Court intended.

The Court agreed with the plaintiff. Justice Hollingworth (at [77]) referred to the Ruling with approval and agreed with the plaintiff (at [78]) that:

...because the very nature of a quantum meruit award is payment for services rendered at an earlier point in time, it is probable that orders made by this court will constitute consideration for an “earlier supply” and so are likely to give rise to a GST liability.

Importantly, the Court noted that it was not being asked to determine, as between the plaintiff and the Commissioner, whether there was a GST liability. The award was to fairly and reasonably reflect a liability which was expected to arise upon payment of

the judgment sum. Further, the Court acknowledged the difficulties in ordering that the defendant provide an indemnity for GST, unless the order was coupled with the obtaining of a private ruling from the Commissioner.

Taking a practical approach to the issue, the Court found that the fairest and most efficient way of dealing with GST was for the defendant to pay 1/10th of the awarded sum to the plaintiff upon receipt of a tax invoice and the plaintiff would provide to the defendant documentary evidence of remitting GST within 30 days of doing so. Any amount not so remitted would be refunded to the defendant.

Reglon Pty Limited v Commissioner of Taxation [2011] FCA 805

The Commissioner issued a GST assessment in respect of a judgment obtained by the taxpayer in the Supreme Court of New South Wales against the defendant for conversion of the taxpayer's scaffolding. The judgment was for \$1,478,125 which was arrived at by reference to expert opinion as to the auction value of the scaffolding.

The Commissioner contended that the taxpayer had made a taxable supply of the scaffolding for the consideration of \$1,478,125. It would appear likely that the Commissioner contended that the taxpayer made a “current supply” by virtue of the court order, being the transfer of the scaffolding.

The Court approached the issue of whether the judgment gave rise to a supply by looking at the nature of a claim in conversion. In finding that there was no supply, the Court said as follows (at [26]):

The effect of the payment in full by Citadel of the judgment in conversion against it was to vest in Citadel the ownership of the Taxpayer’s scaffolding. However, the mere obtaining of judgment in conversion against a defendant does not of itself affect the ownership of the converted goods. Nor does the formal entry of judgment. It is the satisfaction of the judgment that effects a transfer to the defendant of property in the goods that were the subject of the conversion.

And further (at [32]):

The payment made in satisfaction of that judgment resulted in ownership and was triggered by the payment of the judgment sum by Citadel. That payment did not depend upon any action of the Taxpayer. I do not consider that, in those circumstances, the Taxpayer may be said to have **made a supply**. There was no taxable supply by the Taxpayer.²¹

This was the first case dealing with damages where the Commissioner was a party. The Decision Impact Statement²² provides the following explanation for the Commissioner’s contention that Reglon made a supply of the goods or the title in the goods:

- Reglon had instituted the proceedings;

²¹ The Commissioner subsequently published a Decision Impact Statement whereby he accepted that an entity does not, merely by bringing a successful action for conversion, make a supply.

²² Decision Impact Statement dated 5 December 2011.

- The proceedings were to either obtain the return of the goods or an amount equivalent to what it would have received upon the sale of the goods;
- The consequence of Reglon initiating and successfully pursuing the proceedings was that title in the scaffolding passed, and in that sense, Reglon caused a supply of the scaffolding to be made.

The Commissioner filed an appeal to the Full Federal Court, but the Commissioner decided to discontinue the appeal. In the Decision Impact Statement the Commissioner stated that he accepted that an entity does not, merely by bringing a successful action for conversion, make a supply.

GST and out of court settlements

We had to wait until 2014 for the first decision on the GST treatment of an out of court settlement.

Lighthouse Financial Advisers (Townsville) Pty Ltd and Commissioner of Taxation
[2014] AATA 301

The issue was whether a payment made under a Deed of Settlement of legal proceedings for breach of contract was consideration for a supply, being consideration for the surrender of or release from various rights and obligations, including the right to sue.

The Tribunal approached the statutory enquiry in the following way:

26. In respect of out-of-court settlements, such supplies are described in GSTR 2001/4 as “discontinuance” supplies. The Commissioner accepts that the settlement agreement between the parties does contain a discontinuance supply.

27. Whether a discontinuance supply is a taxable supply depends on the requirements of s 9-5 of the GST Act being met in relation to that supply. Under s 9-5(a) a supply is a taxable supply if, among other things, the supply is made “for consideration”.

28. Section 9-15 of the GST Act 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. There must be sufficient nexus between the supply and the payment.

The Tribunal concluded that the payment was not made in consideration of the surrender of the right to sue, noting that such terms are not unusual where litigation is settled. Further, those terms did not give rise to an additional payment and they should not be ascribed a separate value.

The decision of the Tribunal was consistent with the principles in the Ruling regarding the GST treatment of a “discontinuance supply”.

Conclusions to be drawn from the authorities

When regard is had to the cases outlined in this paper, the fundamental principles outlined in GSTR 2001/4 appear sound. In a number of the cases the Courts referred to various parts of the Ruling with approval.

Having regard to the cases discussed above, the following propositions can be distilled:

- In determining an award of damages, that award should be inclusive of GST where the claim relates to the making of an “earlier supply” in which GST was a part, for example a *quantum meruit* claim: *Moraghan v Cospak Pty Ltd*; *Adamson v Ede*; *Peet Limited v Richmond (No 2)*.
- In determining an award of damages calculated by reference to expenses incurred by the plaintiff (or to be incurred), the award should be inclusive of GST where the plaintiff is not entitled to claim input tax credits and exclusive of GST where input tax credits can be claimed: *Nemeth v Prynew Piling Pty Ltd*; *Gagner Pty Ltd trading as Indochine Café v Canturi Corporation Pty Ltd*.
- An award of damages will not be subject to GST: *Gagner Pty Ltd trading as Indochine Café v Canturi Corporation Pty Ltd*.
- The vesting of property in a successful plaintiff in a claim for conversion does not involve a supply of the property by the defendant: *Reglon Pty Limited v Commissioner of Taxation* [2011] FCA 805.
- An order for costs should not be adjusted to take into account the entitlement to input tax credits for solicitors’ professional fees, but an adjustment is appropriate for outlays which attract GST: *ChongHerr Investments Ltd v Titan Sandstone*; *Hennessey Glass and Aluminium Pty Ltd v Watpac Australia Pty Ltd*.²³
- A “discontinuance supply” will not give rise to a taxable supply where that supply was a usual part of settling litigation and the terms of settlement do not give rise to an additional payment for the supply and the supply should not be ascribed a separate value: *Lighthouse Financial*.

THE DECISION IN QANTAS

Other than the decision of the Tribunal in *Lighthouse Financial*, each of the decisions referred to above was handed down before the decision of the High Court in *Qantas*.

The issue was whether the taxpayer made a taxable supply in circumstances where a passenger booked and paid for airline travel, but subsequently did not show for the flight and did not receive a refund of the fare.²⁴

The Tribunal found that the taxpayer made a taxable supply upon the making of the booking and the receipt of the fare, and in doing so adopted an approach that was similar to that of the Tribunal in *Commissioner of Taxation v Reliance Carpet Co Pty Ltd* [2008] HACA 22; (2008) 236 CLR 342. The Tribunal observed as follows (at [9]):

²³ These principles have been adopted by the Commissioner in its practice statements dealing with the GST implications of the recovery of legal costs: PS LA 2008/16 “The GST implications in the recovery of legal costs (professional fees and disbursements) awarded by courts or settled by agreement between parties (withdrawn); replaced by PSLA 2009/9 at Annexure I.

²⁴ Either because the passenger was not entitled to a refund of the fare, or where the fare was fully refundable the passenger did not claim a refund.

The correct view of the Conditions of Carriage seems to us to be that they give rise to a contract enforceable at law between Qantas and each passenger. The contract, in turn, creates rights (s 9-10(2)(e)) and involves entering into obligations “to do anything” (s 9-10(2)(g)). There is, accordingly, an argument that at the time of the creation of the rights and the entering into of the obligations, which will generally be at the time, or shortly after, a reservation is made, there is a supply. Certainly it will be no later than the time of payment. The mutual promises or the payment will provide consideration.

The Tribunal went further and acknowledged that the “circumstance which dominates this case” is that none of the passengers ever undertook their journey, and that the Tribunal must therefore ask itself whether the absence of the actual carriage affected the operation of s 9-10(2)(e) and (g). The Tribunal found that this was not the case. Once it was accepted that a contract was made with passengers, the Tribunal could see no reason why the arrangements with passengers did not fall within both s 9-10(2)(e) and (g).

The Tribunal also considered the question of whether, on the ordinary meaning of “supply” in s 9-10(1), there was a supply when a passenger made a reservation even though the object of the reservation was not fulfilled. The Tribunal observed that the UK cases were concerned more with the ordinary meaning of supply (noting that in Australia it seemed appropriate to address the precise statutory provision). In finding that there was a supply in its ordinary meaning, a way of describing what Qantas had done for a passenger, and in return for the “fare” that had been paid, was holding itself ready to carry the passenger in accordance with its Conditions of Carriage. This was the provision of a sufficient service to give rise to the imposition of GST.

The Full Federal Court

The Full Federal Court unanimously allowed the taxpayer’s appeal.²⁵ Edmonds and Perram JJ observed (at [10]) that at the heart of Qantas’ case was “the simple proposition that the air journey was the supply in contemplation, it did not occur, and therefore no supply occurred; as such no GST liability was, in the event, triggered.”

The Full Court referred to the findings of the Tribunal that “the actual carriage of the passenger” was “obviously the purpose of each reservation” and then noted that French CJ and Hayne J in *Travellex* clearly supported recourse to the purpose of the transaction as identifying the relevant supply. The Full Court then concluded that “the relevant supply” was the contemplated flight, not the reservation or booking, and the contemplated flight failed to occur.

The Full Court found that “the essence and sole purpose” of the transaction was carriage by air – and if the actual travel did not occur there was no taxable supply. The Tribunal erred in artificially splitting the transaction, and in the absence of the principal supply, looked for things otherwise incidental to that supply.

²⁵ Stone J agreed with the judgment of Edmonds and Perram JJ.

The High Court

The majority of the High Court allowed the Commissioner's appeal.²⁶ The majority observed (at [11]-[12]) that the reasoning of the Full Court fixed upon the consideration "for" which a taxable supply was provided and identified this by distilling from the arrangements between airline and customer the "essence and sole purpose" of the transaction.

The majority considered that the appeal turned upon the construction and application of the provisions of the GST Act, particularly the phrase "the supply for consideration" in the definition of "taxable supply" in s 9-5(a), noting that the word "for" does not adopt contractual principles but requires a connection or relationship between the supply and the consideration.

The majority then observed that the decision in *Reliance Carpet* was treated as if it supported the contention by Qantas that the sole candidate for a taxable supply was the flight, for which the fare was pre-paid, to the exclusion of the supply by reason of the making of the contract of carriage upon payment of the fare. In response to this purported reliance, the majority's view was clear:

The case provides no support for the proposition adopted by the Full Court in the present case that it was necessary to extract from the transaction between the airline and the prospective passenger the "essence" and "sole purpose" of the transaction.

The majority concluded as follows (at [33]) (footnotes excluded):

The Qantas conditions and the Jetstar conditions did not provide an unconditional promise to carry the passenger and baggage on a particular flight. They supplied something less than that. This was at least a promise to use best endeavours to carry the passenger and baggage, having regard to the circumstances of the business operations of the airline. This was a "taxable supply" for which the consideration, being the fare, was received.

THE DECISION IN MBI PROPERTIES

The facts can be shortly stated:

- South Steyne Hotel Pty Ltd ("South Steyne") purchased a hotel complex in 2000 and in 2006 a plan of strata subdivision was registered whereby the hotel complex was divided into 84 strata lots, each comprising an apartment in the hotel complex.
- Later in 2006, South Steyne entered into a lease with MML in respect to each of the 83 lots. Under each lease MML (as lessee) was obliged to use the apartment as part of a serviced apartment business.
- In 2007 South Steyne sold three apartments to MBI. Each apartment was sold subject to the lease and was stated to be the sale of a going concern. Each contract permitted MBI to participate in the serviced apartment business. MBI elected to participate.

²⁶ Gummow, Hayne, Kiefel and Bell JJ. Heydon J dissented.

The issue was whether MBI had an increasing adjustment pursuant to s 135, which provides as follows:

- (1) You have an *increasing adjustment* if:
 - (a) you are the *recipient of a *supply of a going concern, or a supply that is *GST-free under section 38-480; and
 - (b) you intend that some or all of the supplies made through the *enterprise to which the supply relates will be supplies that are neither *taxable supplies nor *GST-free supplies.
- (2) The amount of the increasing adjustment is as follows:

where:

“*proportion of non-creditable use*” is the proportion of all the supplies made through the

History of the litigation – South Steyne

The matter has a long litigious history, with MBI and South Steyne applicants in earlier proceedings against the Commissioner in the Federal Court. In *South Steyne Hotel Pty Ltd v Commissioner of Taxation* [20009] FCAFC 155; (2009) 180 FCR 409 the Full Federal Court found that the apartments sold by South Steyne to MBI were “residential premises” within the meaning of the GST Act and that the sale of each apartment subject the existing lease with MML was GST-free under s 38-325 as the supply of a going concern – South Steyne supplied to MBI all of the things necessary for the continued operation of the serviced apartment business that South Steyne was to carry on until the completion of the contract of sale.

Unexpectedly, notwithstanding the common position of the parties, the Full Court held that MBI’s purchase of the apartments (subject to the lease to MML) did not result in a supply by MBI (as the new landlord) to MML (as tenant). The Full Court found that, by operation of law, each apartment lease (being a supply) continued after the sale with MBI succeeding to the rights and obligations of South Steyne as owner under the lease – this “continuation” was not sufficient to constitute a supply.

Section 135 – the Federal Court proceedings

MBI objected to the Commissioner’s assessment on the basis that s 135 could not apply because MBI did not make any supplies under the lease, relying on the finding of the Full Court in *South Steyne*.

The Commissioner disallowed the objection and the appeal was heard by the Federal Court and on appeal to the Full Federal Court. At no stage did the Commissioner dispute the finding of the Full Federal Court in *South Steyne* that the “continuation” of the apartment lease did not result in a supply by MBI to MML. The Commissioner contended that the continuation of the lease resulted in a continuation of the input taxed supply of residential premises by way of lease from South Steyne to MML and this was sufficient for s 135-5 to apply.

At first instance, the Federal Court agreed with the Commissioner. The Full Federal Court allowed the appeal by MBI Properties, with the Court finding that the supply constituted by the grant of the lease between South Steyne and MML did not continue

beyond the grant. Further, even if the supply did survive the grant, it did not survive the sale of the reversion from South Steyne to MBI. As there was no supply at all following the sale of the apartments to MBI, there was no input taxed supply which MBI could have intended to make through its enterprise. Accordingly, there could be no increasing adjustment under s 135-5.

High Court

On appeal to the High Court, the Commissioner abandoned his arguments put in the Courts below and challenged the conclusion of the Full Court in South Steyne that the continuation of each apartment lease after the sale of the apartments did not result in MBI making a supply to MML. The Commissioner contended that, from the time of grant, each lease had the dual character of an executed demise and an executory contract. Under the executory contract the lessor was obliged to continue to give the lessee use and occupation of the apartment in consideration of the periodic payment of rent. MBI became subject to those obligations upon purchasing the reversionary interest in the apartments.

The High Court agreed with the Commissioner, and in explaining its reasons the Court, made a number of important observations on the concept of “supply”:

- It is wrong to consider that one transaction must always involve the making of just one supply. It is similarly wrong to consider that the making of a supply must always involve the taking of some action on the part of the supplier: at [33].
- There is a supply whenever one entity (the supplier) provides something of value to another entity (the recipient) – the thing can be provided by means of the supplier refraining from acting, or by means of the supplier tolerating some act or situation, just as it can be provided by means of the supplier doing some act: at [34].
- A transaction which involves a supplier entering into and performing an executory contract will in general involve the supplier making at least two supplies: a supply which occurs at the time of entering into the contract, in the form of both the creation of a contractual right to performance and the corresponding entering into of a contractual obligation to perform; and a supply which occurs at the time of contractual performance, even if contractual performance involves nothing more than the supplier observing a contractual obligation to refrain from taking some action or to tolerate some situation during a contractually defined period: at [35].
- With regards to a lease - there will in general be a supply which occurs at the time of entering into the lease. That supply will involve a grant within the scope of s 9-10(2)(d) combined (as contemplated by s 9-10(2)(h)) with the creation of contractual rights within the scope of s 9-10(2)(e) and with the entry into contractual obligations within the scope of s 9-10(2)(g). There will then be at least one further supply which occurs progressively throughout the term of the lease. That supply will occur by means of the lessor observing and continuing to observe the express or implied covenant of quiet enjoyment under the lease. The thing of value which the lessee thereby receives is continuing use and occupation of the leased premises: at [36].

THE “NEXUS” BETWEEN SUPPLY AND CONSIDERATION – POST *QANTAS AND MBI PROPERTIES*

Propositions

Having regards to the decisions in *Qantas* and *MBI Properties*, the following propositions can be stated:

- The definition of “supply” in s 9-10 includes the entry into obligations upon contract.
- To identify a supply it is not necessary to extract from the transaction the “essence” and “sole purpose” of the transaction.
- It is wrong to consider that one transaction must always involve the making of just one supply.
- It is wrong to consider that the making of a supply must always involve the taking of some action on the part of the supplier.
- There is a supply whenever one entity (the supplier) provides something of value to another entity (the recipient) – the thing can be provided by means of the supplier refraining from acting, or by means of the supplier tolerating some act or situation, just as it can be provided by means of the supplier doing some act.
- A transaction which involves a supplier entering into and performing an executory contract will in general involve the supplier making at least two supplies: a supply which occurs at the time of entering into the contract, in the form of both the creation of a contractual right to performance and the corresponding entering into of a contractual obligation to perform; and a supply which occurs at the time of contractual performance.
- The words “the supply *for* consideration” do not adopt contractual principles but require a connection or relationship between the supply and the consideration.

What is the nexus?

In the context of judgments and out of court settlements, in most (if not all) cases it will be possible to identify “consideration” and at least one “supply”.

While the decisions of the High Court confirm the need for a “nexus” between supply and consideration, other than observing that the nexus requires a “connection” or “relationship” between the supply and the consideration, the decisions provide no real assistance as to the nature of that connection or relationship.

In GSTR 2006/9 the Commissioner’s position is that there must be a substantial relation, in a practical business sense, between the consideration and the supply.²⁷

The approach of the Commissioner is consistent with the decision of the Full Federal

²⁷ GST Ruling GSTR 2006/9 at [180] referring to *Berry v FC of T* (1953) 89 CLR 653 at 659 per Kitto J.

Court in *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126; (2005) 143 FCR 553.²⁸ Hill J (at [35]) made the following observations:

...the words "relates to" are wide words signifying some connection between two subject matters. The connection or association signified by the words may be direct or indirect, substantial or real. It must be relevant and usually a remote connection would not suffice. The sufficiency of the connection or association will be a matter for judgment which will depend, among other things, upon the subject matter of the enquiry, the legislative history, and the facts of the case. Put simply, the degree of relationship implied by the necessity to find a relationship will depend upon the context in which the words are found.

In the context of s 11-15(2)(a), the following principles can be derived from the judgment of Hill J in *HP Mercantile*:

- the words "relates to" require a real and substantive relationship between the acquisition and the making of supplies that would be input taxed;
- the relationship may be direct or indirect;
- a "real and substantial" relationship is one which is not "trivial" or "remote"; and
- it is a question of objective fact whether a sufficient relationship exists in a particular case.

In my view, the same principles can be applied to the words "in connection with". Accordingly, "any" connection between a supply and consideration would not be sufficient. A trivial, remote, or insignificant connection would not suffice. The relationship must be a real and substantial one.

SPECIFIC ISSUES

In light of the decisions of the High Court in *Qantas* and *MBI Properties*, two issues arise for consideration.

Issue 1 - is the payment under a settlement agreement made "in connection with" the discontinuance supply?

Where a settlement agreement is entered into, each of the elements in s 9-5 is arguably satisfied, regardless of whether an "earlier supply" or a "current supply" can be identified.

Each element is considered below:

- The discontinuance supply made by plaintiff falls within the broad definition of "supply" in s 9-10 (as acknowledged in the Ruling at [68]-[70]). It is something of value provided by the plaintiff to the defendant (being in the form of a release): *MBI Properties*. Further, the discontinuance supply could not be regarded as "trivial" or "remote" – it is an important term and the defendant would not enter into the settlement agreement without it.

²⁸ A similar approach was taken by the Federal Court in *Rio Tinto Services Ltd v Commissioner of Taxation* [2015] FCA 94.

- The payment to be made by the defendant (being “consideration”) acts to bind the parties to the settlement agreement. The payment therefore has a direct connection the discontinuance supply made by the plaintiff, being one of the executor obligations of the plaintiff under the settlement agreement. Support for this view is found in the following observation of the High Court in *Reliance Carpet* when characterising the deposit paid by the purchaser (at [33]):

First, as to the consideration. The payment of the deposit by the purchaser to the taxpayer was “in connection with” a supply by the taxpayer, within the meaning of the definition of “consideration” in s 9-15(1)(a) of the Act. That connection is readily seen from the circumstance that, with the receipt of the written notice of the exercise of the option by the purchaser, and by force of cl 5 of the Option Agreement, the payment of the deposit obliged the parties to enter into the mutual legal relations with the executory obligations and rights laid out in the Contract.

- That the consideration may also be connected with something that is not a supply (eg, a claim for damages) or that the “subject matter” of the settlement agreement is a claim for damages is arguably not relevant.²⁹ In *Reliance Carpet* the taxpayer contended that the forfeited deposit was received by it “in the nature of damages”, with the consequence that there was no “supply” in connection with the forfeited deposit. The High Court rejected this contention, noting that no action had been taken by the taxpayer to recover any alleged damages for failure to complete the contract. The High Court made the following observation after reviewing the various characteristics of a deposit (at [28]):³⁰

The circumstance that the deposit forfeited to the taxpayer had various characteristics does not mean that the taxpayer may fix upon such one or more of these characteristics as it selects to demonstrate that there was no taxable supply. It is sufficient for the Commissioner’s case that the presence of one or more of these characteristics satisfies the criterion of “consideration” for the application of the GST provisions respecting a “taxable supply”.

- The Commissioner’s written submissions in *Qantas* characterised the statutory question in the following broad terms:

41. The statutory question posed by ss 9-75 and 9-15 is whether there was a supply of anything for which the unused fares were consideration (ie, in connection with which they were paid).

...

44. ...What the Act does say is that “a supply is any form of supply *whatsoever*”, that “consideration includes *any* payment ... *in connection with* a supply of *anything*”, and that a taxable supply is (relevantly) one made for consideration. There is no basis for limiting words of such explicit breadth by notions of essence, purpose or “relevance”.

²⁹ In GSTR 2003/11 the Commissioner acknowledges (at [64]) that an amount can have both the character of damages, a penalty or compensation and also be consideration in connection with a supply.

³⁰ In *Qantas* the majority of the High Court (at [26]) referred to these observations.

Having regard to the matters outlined above, it could be argued that all payments made under settlement agreements will be consideration for a taxable supply made by the recipient (being the discontinuance supply), regardless of whether:

- an “earlier supply” or a “current supply” can be identified; or
- whether the payment is to resolve a claim for damages.

Should the discontinuance supply be ignored?

The basis for the Commissioner’s view in the Ruling that a “discontinuance supply”, on its own, will generally not give rise to a taxable supply appears to be that the supply is to be effectively ignored.

As stated in paragraph [107] of the Ruling:

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.

The essential trust of the Commissioner’s position appears to be that the payment is not “for” the discontinuance supply. The payment is for something else, whether that be the current or earlier supply, or the payment is in the nature of damages.

The difficulty with the Commissioner’s position is that at first glance it appears to require the very thing that the High Court rejected in *Qantas* – namely that identifying “subject matter” of the transaction – or its “essence” or “sole purpose” – allows a connection between the payment and some other supply to be ignored.

However, in my view this is not the effect of the decision in *Qantas*. In taking this view, I take comfort in the approach of the majority of the Full Federal Court in *AP Group Limited v Commissioner of Taxation* (2013) 214 FCR 301 (*AP Group*).

AP Group

In considering the nature of the connection or relationship required in s 9-5, the definition of “consideration” must also be considered. In *AP Group* Edmonds and Jagot JJ (at [32]) observed that if the definitions were inserted in substitution for the defined terms where they appear in s 9-5, the result was as follows:

...you make [any form of supply whatsoever] for [any consideration, within the meaning given by sections 9-15 and 9-17 in connection with the supply or acquisition].

This is a difficult phrase.

Their Honours (at [33]) helpfully explained that these words meant the following:

- The consideration must be “in connection with” the supply but the supply must also be “for” the consideration.
- “For” in this context means, “in order to obtain”.

- The word “for” identifies the character of the connection which is required and ensures that not every connection of any character between the making of a supply and the payment of consideration would suffice.

It would appear that their Honours took the view that the words “for” provide the context in which to construe the words “in connection with”.

It is interesting to compare the approach of Edmonds and Jagot JJ with that of the High Court in *Reliance Carpet*, where the High Court (at [33]) made the following observation about the connection between the deposit paid by the purchaser of real estate and a supply by the vendor:

The payment of the deposit by the purchaser to the taxpayer was "in connection with" a supply by the taxpayer, within the meaning of the definition of "consideration" in s 9-15(1)(a) of the Act. That connection is readily seen from the circumstance that...the payment of the deposit obliged the parties to enter into the mutual legal relations with the executory obligations and rights laid out in the Contract. Those legal relations were directed to the completion of the Contract by conveyance of the property to the purchaser by the taxpayer upon payment by the purchaser.

Edmonds and Jagot JJ (at [34]) acknowledged that the question of whether there was a taxable supply had been expressed in terms of “connection” in numerous decisions, including in *Reliance Carpet*. Their Honours stated that in no case did the analysis begin and end with that question and in each case the nature and extent of the connection was also analysed to ascertain whether the supply was made for the consideration.

Adopting this approach to the facts in *Qantas*, what their Honours appear to be saying is that the fare was paid “in connection with” the supply of best endeavours by Qantas and the payment was **also** “for” that supply.

This approach clarifies the basis of the Commissioner’s approach to discontinuance supplies in the Ruling. It may be said that the settlement payment is “connected with” the discontinuance supply and that the connection is not remote or trivial. However, the payment is not made “for” the discontinuance supply – it is part of the machinery by which the parties have agreed to resolve the dispute. Therefore the statutory criterion in s 9-5(a) is not satisfied.

An example of the application of this approach is found in the decision of the Tribunal in *Lighthouse Financial Advisers*, which is discussed above. The issue was whether a payment made under a Deed of Settlement of legal proceedings for breach of contract was consideration for a supply, being consideration for the surrender of or release from various rights and obligations, including the right to sue. The Tribunal concluded that the payment was not made in consideration of the surrender of the right to sue.

In my view, the decision of the Tribunal was correct. The payment satisfied the first limb of the statutory enquiry (ie, the payment was “in connection with” the surrender). However, the payment did not satisfy the second limb. The payment was not “for” the surrender.

Issue 2 – can a judgment give rise to a taxable supply?

In the Ruling the Commissioner confirms that he does not consider that:

- a court, in giving judgment, makes a supply for GST purposes; and
- the extinguishment of a judgment debt by its payment does not constitute a supply by the judgment creditor.

The essential reasoning for this view is that these matters do not depend on any action on the part of the “supplier”. In *Shaw v Director of Housing* the Court found that the obligation of a judgment debtor to pay a judgment sum, extinguished by the act of payment, did not constitute a supply because it did not depend upon any action on the part of the judgment creditor

In *MBI Properties* the High Court made the following observations:

- There is a supply whenever one entity (the supplier) provides something of value to another entity (the recipient); and
- It was wrong to consider that the making of a supply must always involve the taking of some action on the part of the supplier.

These observations raise the question of whether the making of a judgment or its satisfaction can give rise to a taxable supply, particularly where the result of that judgment is that ownership of property is transferred from one party to another. An example is a successful action for conversion, as in *Reglon*.

In the Decision Impact Statement for the decision, the Commissioner described the finding of the Court in the following terms:

The Court considered (at paragraph 29 of the judgment) that under the law of conversion the correct construction is that 'payment of a judgment in conversion, where the value of the converted goods is given as damages, is taken to be a **purchase** , not a **sale** .' Further (at paragraph 32), the Court decided that:

The payment made in satisfaction of that judgment resulted in ownership of the scaffolding vesting in Citadel. That is, the transfer of ownership to Citadel, and the extinguishment of the Taxpayer's ownership by operation of law, occurred without assent and was triggered by the payment of the judgment sum by Citadel. That payment did not depend upon any action of the Taxpayer. I do not consider that, in those circumstances, the Taxpayer may be said to have made a supply.

That is, the Court found that in an action for conversion the transfer of title occurs by operation of law upon the payment of the judgment sum and requires nothing by, in this case, Reglon in the way of making a supply. As there was no supply made by Reglon, there was no taxable supply.

Having regard to the above extract, a successful action in conversion appears to receive a similar GST treatment to a compulsory acquisition of land, which the Commissioner accepts does not give rise to a supply where the owner does not take

any positive action.³¹

In both cases, the result or consequence is as follows:

- the owner's interest in the property is extinguished by operation of law and does not depend on any action by the owner; and
- ownership in the property vests in the acquirer – rather than there being a transfer of ownership from one party to another.

The issue is whether this legal consequence constitutes a supply within the meaning of s 9-10.

The first point to make is that a supply need not be sourced in contract, and may arise by operation of law. An example is *MBI Properties* where MBI Properties (as the purchaser of the reversion interest in the land) entered into the obligation to observe and continue to observe the express or implied obligation under the lease by reason of s 40(3) of the *Real Property Act 1900* (NSW) and s 118 of the *Conveyancing Act 1919* (NSW).³²

The second point to make is that the Commissioner appeared to initially hold an earlier view that a supply could be a "a legal consequence", not requiring a conscious or deliberate act on the part of the supplier. This submission was made to the Full Federal Court in *Westley Nominees* in support of his contention that the acquirer of real property subject to an existing lease made a supply to the lessee within the meaning of s 9-10. That view may have also been the driver for his position in *Reglon*. However, the Commissioner appears to have moved away from that view and in GSTR 2009/6 he distinguishes between something that is brought about solely by the operation of law (where there is no supply) and something done by an entity as a consequence of a legal requirement (where there may be a supply).³³

In my view, the observations of the High Court in *MBI Properties* are not to be taken to expand the concept of supply to all cases where there is a change in ownership in property. What the High Court appears to be saying is that in **some** circumstances there may be a supply where the supplier does not take any positive action. The example referred to by the High Court was where the supplier enters into an obligation to agree not to do something or to tolerate something. In a sense, that obligation can be seen as a positive action by the supplier. The supplier was doing something in return for the payment.

In my view, the decision does not impact on the GST treatment of cases such as *Reglon* (or compulsory acquisition cases) where the "legal consequence" of the action is that ownership in property vests in another entity but the previous owner does not take any positive action to effect the vesting.

³¹ GSTR 2006/9 at paragraphs 81-91. Support for this view is found in *CSR Ltd v Hornsby Shire Council* (2004) 57 ATR 201; [2004] NSWSC 946; *Hornsby Shire Council and Commissioner of Taxation* (2008) 71 ATR 442; [2008] AATA 1060; *SXGX and Commissioner of Taxation* [2011] AATA 110.

³² See also *Westley Nominees Pty Ltd v Coles Supermarkets Australia Pty Ltd* (2006) 152 FCR 461; [2006] FCAFC 115 at [22].

³³ GSTR 2006/9 at paragraph 78.

Chris Sievers

Lonsdale Chambers

22 April 2016