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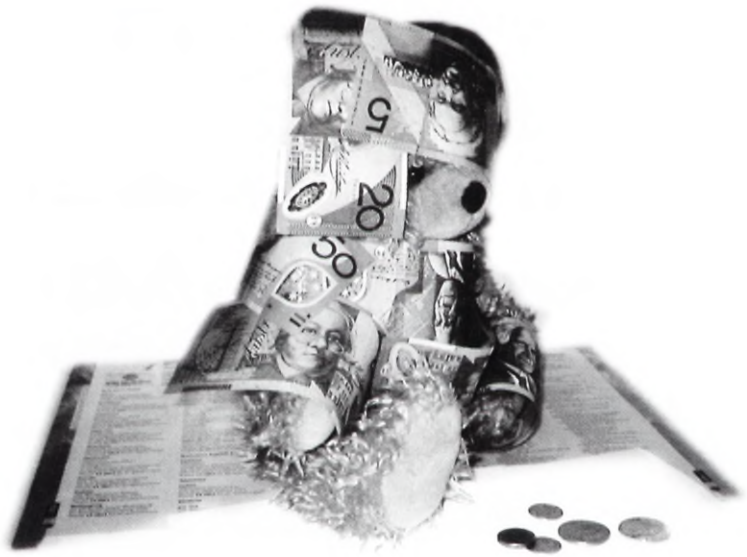
GST in personal injuries & damages



Abridged version of a paper presented at the Queensland Law Society's Personal Injuries Conference, held 27-28 July 2001.

Scope of this paper

For the majority of personal injuries practitioners, GST relating strictly to personal injuries damages awards is a non-issue. The plaintiff would usually not be liable to GST on the receipt. The defendant insurer usually has the internal operation of GST on their businesses worked out, and are not asking litigation lawyers for input on that point.

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I propose to cover the following:

- The technical reasons why plaintiffs in personal injuries matters usually have no GST liability on receipt of damages.
- Quantum.
- Interest.
- Costs. This seems to be a hot issue.
- Wording of settlement agreements.

The legislation I will be referring to is *A New Tax System (Goods and Services Tax) Act* 1999 (***GST Act***), and the regulations made under it (***GST Regulations***).

Position of the Plaintiff

There are some interesting issues about whether a payment by a defendant to a plaintiff can ever result in a supply, let alone a taxable supply.

However, for the most part, plaintiffs in personal injuries matters are not liable to pay GST for a couple of straightforward reasons.

To be liable for GST on any "supply", the plaintiff must make the supply *in the course or furtherance of an enterprise* the plaintiff carries on.[1] Also, to be taxable, the supplier must be registered or required to be registered.[2]

Assume the hardest case - a self-employed sole trader injured driving deliveries in the course of her business. The settlement of her personal injuries claim has nothing to do with her business, though the loss might be quanti-

fied by reference to her lost earnings from that calling. Rather, the settlement relates to her personal injuries.[3]

Of course, if the delivery driver is employed, the matter becomes simpler. An employee is incapable of carrying on an enterprise as such,[4] and is therefore incapable of being registered as such.[5] Note, if the delivery driver's employer seeks compensation for loss of earnings, due to loss of a trained delivery driver for a week, the analysis is quite different, though the answer ought to be the same![6]

Quantum

For the vast majority of personal injuries settlements, the plaintiff has no direct GST liability on receipt of the cash.

However, the claim has to be quantified. The damages are meant to place the plaintiff, as best money can do, in the same position as the plaintiff would have been but for the defendant's negligence.

The plaintiff's loss of earning capacity now has to be assessed against generally lower income tax scales. This reduction in personal income tax was part of the Federal Government's *New Tax System*.

The plaintiff's loss may also include future medical care and attendances. There may be nursing care, various types of therapies, residential or community care.

What is, and what is not, exempt under **subdivision 38-B GST Act** (which relates to health care and ancillary matters), is beyond the scope of this paper.

That is because the person injured simply must put a case about what the future care and needs might cost (and the court can reasonably assume that an injured person will not be entitled to input tax credits).

Therefore, the real question is to determine the GST-inclusive costs of, say, the home modifications, prosthetics, and reconstructive dental work. The fact that home modifications may be subject to GST, the prosthetics not, and the dental work debatable, is entirely irrelevant.

Interest

Interest is not really a significant ▶

GST issue in personal injuries litigation. The arguments are:

- That the injured party is usually not making any supply when receiving payment under a court order;[7]
- That the injured party makes no supply in the course of an enterprise when signing a release as part of a settlement;
- There is no proper connection between the amount paid and any relevant supply.

COSTS

Solicitor-Client – the engagement letter

The GST adjustment

Solicitors will, by now, have adjusted their terms of engagement so as to reflect increased time cost rates. I understand that firms have taken some care to comply with the price exploitation rules.[8] Savvy solicitors will have reserved the right further to increase rates in the event that the rate of GST increases.

Controversial disbursement issues

There have been questions about how a solicitor ought to treat disbursements.

"Costs are treated now as entirely a creature of statute."

Specifically, you generally charge to the client:

- Only the net amount of the disbursement,
- Then add your own GST to that net amount relating to the on-supply by you of the item.

In other words, you do not pass on to the client the full price, adding further GST. This is because you will generally be entitled to an input tax credit yourself.[9]

I note that the Law Society of New South Wales put the question of counsel's fees to ATO for resolution. It did so on the basis that a solicitor routinely engages counsel as a mere agent of the client.[10] In that case, the barrister's fee note might presumably be addressed either to the client or the solicitor (as agent of the client).

That is not the case in Queensland. I conclude that there must be some regional variation in practices or the statute law in this regard. In short, in Queensland the barrister is engaged by the solicitor, principal to principal. Issues about GST and agency are therefore irrelevant to that relationship.

"...the real question is to determine the GST-inclusive costs..."

There is a further difficulty in relation to disbursements. Some disbursements are in respect of items in the Treasurer's determination under **section 81-5(2)** GST Act. This means that the payment of a prescribed court fee does not give rise to a creditable acquisition by the solicitor.

When the solicitor invoices the client for services (including filing the claim in court), the solicitor must gross up the filing fee, as the solicitor is liable for GST when passing on that filing fee.[11] If the client is not in a position to claim an input tax credit for the GST charged, there is an economic loss to the client.

I understand that most solicitors have now introduced procedures to ensure that private or input taxed clients are not disadvantaged that way. Either the solicitor's terms of engagement appoints the solicitor as the agent of the client to incur such disbursements, or the client writes a cheque directly in favour of the court registry or other authority.

Straddling matters

Difficult issues remain in relation to ongoing matters that straddled 1 July 2000, the commencement of GST.

The technical question is usually whether the engagement is effectively grandfathered as GST-free in terms of **section 13** of the transition rules. Looking at the matter in general terms, it is at least necessary to look at specific documents used from time to time in a practice, to determine if:

- There was a written agreement with each client.
- That agreement specifically identified the supply in question – that is, the supply for which you will invoice the client, presumably applying the amount of the invoice against the receipt from the defendant held in trust.
- That agreement identified the consideration in money (or at least a way to work it out in monetary terms).
- That agreement provided no "review opportunity".[12]

For most contingency fee agreements, the client would not have been entitled to a full input tax credit for the legal fees. Therefore, grandfathering would only have been possible if the agreement was made before 2 December 1998.[13]

Solicitor-Client – the assessment

Should a solicitor fall into dispute with a client, there are mechanisms by which the solicitor's bill can be recovered. There are also mechanisms by which the bill can be assessed.

Under Queensland law, a solicitor may be limited to costs determined under a court scale in some circumstances.[14] A glance at the relevant scales for Queensland courts indicates that there is no express provision for addition of an amount on account of the GST liability of the solicitor. There is no easy way of implying a right to a GST gross-up.

Costs awarded in court

There are really two questions here. First there is the issue of whether the court scale permits an uplift for GST. Secondly, there is the question of whether the payment by one party to the other of court ordered costs results in a supply of anything by one to the other.

The scale and uplift

Costs are treated now as entirely a creature of statute. In practice, I would suggest that it is entirely pointless to ask a person appointed to assess costs to do something not permitted by statute.

In summary, unless the statute, a regulation, or the rules permit uplift for GST, as a practical matter the person assessing costs cannot, and therefore should not, increase the award for GST.

The Australian Taxation Office has commented on the circumstances in which the input tax credit available to a business litigant should be taken into account in a costs award. Ruling GSTR 2001/4[15] shows no understanding of how costs are assessed. This contribution to the debate should be dismissed.

Whether GST applies to payment of the costs

The second question is whether payment of court ordered costs by one party to the other results in a taxable supply by one party to the other.

Of course, for the plaintiff in personal injuries litigation, this whole topic is usually irrelevant. Refer above to "Interest" and to the following, with necessary adaptations.

However, for the defendant lawyers, I ought to say what the situation is where the business litigant is awarded costs. The concern might be that there is some kind of release or surrender of a right by the payee, amounting to a *supply*. This is not correct. Payment of the award is not a release or surrender by the payee of any right. It is the mere discharge or satisfaction of that right.

GSTR 2001/4 comes to the conclusion that payment of costs is not a taxable supply by the payee.[16] It does so by a different route.

Wording of settlement agreements

The wording of settlement agreements can be critical where there is something other than an agreement for the payment of damages to an individual for personal injuries. For the most part, the wording of settlement agreements in the personal injuries context will have little GST impact.

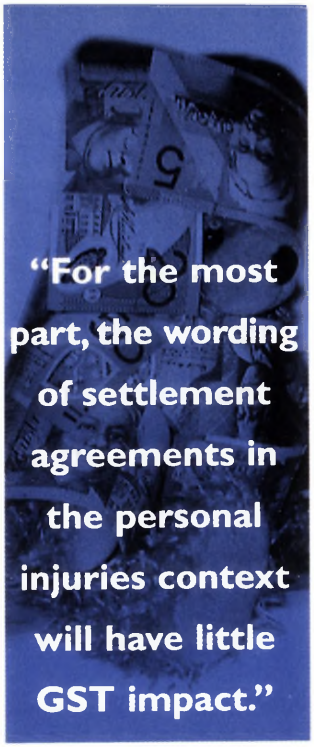
If the matter is not related to personal injuries, there can be some margin in attending to the wording of the settlement agreement. If the dispute can be categorised within the class of "claims for damages arising out of property damage, negligence causing loss of profits, wrongful use of trade name, breach of copyright, termination or breach of contract or personal injury"[17] an effort ought to be made to document the settlement as directly relating to those matters.

This is because ruling GSTR 2001/4 concludes that the payment is not consideration for a supply.[18]

If the claim falls within this "damages" exclusion from GST, document the settlement agreement that way. Recite the claim for damages, the fact that it is disputed, and the fact that payment is nevertheless made (albeit without admission of liability).

The ruling provides that, if the only "supply" in relation to the settlement is the discontinuance of a claim, a payment for such discontinuance will usually have no sufficient connection with the "discontinuance supply" for the discontinuance supply to be a "taxable supply".[19]

Again, especially for non-personal injuries matters, apportion consideration between heads of damages. In the process, overcome any woolly thinking by identifying the heads of damages (at least in your own mind) as relating to any earlier supply, to any current supply by the settlement, to pure damages, and to discontinuance (if relevant separately). PL



Footnotes:

1 Section 9-5(b) GST Act

2 Section 9-5(d) GST Act

3 This follows, by inference, from cases such as *Cullen v Trappell* (1980) 146 CLR 1 at 7 (Barwick CJ) and *Atlas Tiles Ltd v Briers* (1978) 144 CLR 202 at 210 (Barwick CJ).

4 Section 9-20(2)(a) GST Act

5 Section 23-10 GST Act

6 In this example, the answer ought to be the same as for the employee's personal injury claim: ruling GSTR 2001/4, paragraphs 71, 110-114.

7 *Interchase Corporation Limited v A.C.N. 010 087 573 & others* 2000 ATC 4552 at 4554, paragraph [57]

8 Part VB *Trade Practices Act* 1974 (Cth)

9 If you are not entitled to an input tax credit, things become more difficult.

10 Refer to: http://www.lawsocnsw.asn.au/practice/gst/faq/faq-10_-2.html

11 This would follow from GSTD 2000/10, paragraph 8, which deals with an analogous situation under a lease. If the tenant is liable to reimburse the landlord for rates, for example, GSTD 2000/10 states that the Division 81 Determination does not protect the reimbursement.

12 Section 13(5) of the transitional rules.

13 Section 13(4) of the transitional rules

14 Section 48I(1)(b) *Queensland Law Society Act* 1953 (Qd)

15 Refer paragraph 149.

16 Paragraph 149 of GSTR 2001/4

17 GSTR 2001/4, para. 71

18 GSTR 2001/4, para 110 and following.

19 GSTR 2001/4, para. 106 and following.