



# COMMON LAW CLAIMS:

# The impact of the

**i**t is necessary to understand the workings of the GST in order to determine the impact of this new tax on common law claims. The latter part of this article will focus particularly on personal injury claims.

## The framework of the GST

The following is a brief summary

only and provides a broad overview of the main features of GST.

The Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Act 1999* ("the GST Act") provides the following Executive Summary of the GST:

"The GST is a broad based indirect tax introduced by the Government to replace the wholesale sales tax and a number of State indirect taxes. Broadly speaking the GST is a tax on private consumption in Australia. The GST taxes the consumption of most goods, services and anything else in Australia, including things that are imported. Generally, the GST will not apply to consumption outside Australia, which is why the GST does not apply to exports.

This is generally achieved by:

- imposing tax on supplies made by entities registered for GST; but
- allowing those entities to offset the GST they are liable to pay on supplies they make against input tax credits for the GST that was included in the price they paid for their business inputs."

The essential elements of Australia's proposed GST are as follows:

1. It is a broad-based consumption tax on supplies of goods, services and many other "things". The Government's policy is to limit the number of exemptions e.g. taxing essential "non luxury" goods such as tampons.
2. GST is a value-added tax ("VAT") imposed at all stages of production/distribution and is similar to other VATs e.g. New Zealand, Canada and Europe.

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# GST

3. There are credits for input tax, i.e. GST charged on supplies to purchasers.
4. Most importantly to business, it is a tax on private final consumption expenditure meaning that the end-consumer pays the tax rather than business.

## Meaning of taxable supply

GST only applies to those supplies of things which are taxable (see section 9-1 of the GST Act). Further, section 9-5 provides that "you make a taxable supply if:

- (a) you make the supply for \*consideration; and
- (b) the supply is made in the course or furtherance of an \*enterprise that you \*carry on; and
- (c) the supply is \*connected with Australia; and
- (d) you are registered, or are \*required to be registered.

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

The expressions in Section 9-5 which are marked with an asterisk are defined in the Dictionary included in

the GST Act at Division 195. For example, "consideration" is defined and this expression will be considered later in this article in relation to the question whether compensation or damages received under either court orders or out of court settlements are subject to GST.

## Non-taxable supplies

The intention of the Government has always been to introduce a consumption tax which has very few exemptions. This has been largely achieved with the notable exception of the Democrats' initiated exemptions for a range of food items.

There are two categories of non-taxable supplies, namely, GST-free supplies and input taxed supplies.

GST-free supplies will be as follows:

- Food (however, a number of categories will be taxable e.g. confectionery, biscuits, restaurant meals and "prepared food")
- Health
- Education
- Child care
- Exports
- Religious services

- Non-commercial activities of charitable institutions
- Raffles and bingo conducted by charitable institutions
- Water and sewerage services
- Supplies of going concerns
- Supplies of international transport
- Supplies of precious metals (i.e. first supply after its refining by the supplier)
- Supplies through inwards duty free shops
- Grants of free-hold and similar interests by Governments
- Sub-divided farmland for residential use and farm land supplied for farming
- Cars for use by disabled people

The following supplies will be input taxed:

- Financial supplies
- Residential rent
- Sales of residential premises
- Supplies of residential premises by way of long-term lease
- Precious metals (other than first supplies of such metals)
- Supplies of food through school tuckshops and canteens

## The impact of GST on pricing and personal injury claims

In considering the impact of GST on personal injury claims it is necessary to consider the impact of both the proposed GST and the other taxation reforms on the pricing of goods, services and other supplies.

Evaluating the effect of GST on prices is not as straightforward as simply identifying those goods and services which will be subject to GST and adding 10%. Many goods are presently subject to sales tax at a rate of up to 22% of the wholesale selling price of the goods. Some other indirect taxes may also apply to certain services and property transactions. Sales tax (and some other indirect taxes) will cease to apply on and from 1 July 2000. Accordingly, the effect of the removal of these taxes must be taken into account when evaluating the GST on prices.

It is difficult to directly compare the effects on price of removing tax at a wholesale level and adding a retail tax. Even for services which were not subject to sales tax but which will be taxable under the GST, market factors may determine whether suppliers will fully recover both GST and compliance costs associated with the GST.

Prior to the Federal election in October 1998, the Coalition Government evaluated the price effects of the New Tax System for 107 industries. The results were set out in their tax reform publication entitled *Tax Reform: Not A New Tax, A New Tax System*, released in August 1998.

However, each industry includes a large number of products and services, many of which may be treated differently for GST purposes. In these circumstances, the Coalition's estimates can only be regarded as a conservative guide to the likely GST impact on prices. In some instances, the price effect estimated for the industry may be inapplicable to the particular good or service in question.

In evaluating the impact of GST on the prices of the items required by a typical plaintiff in a personal injury claim

for that person's future treatment and using the Coalition's price estimates, the following should be borne in mind:

1. Many of the 107 industries identified by the Government cover a variety of goods and/or services which differ in both sales tax and GST treatment. The industry price estimates accordingly reflect the average price shown for those goods and services. This average may not be applicable to the particular goods and services required by a plaintiff.
2. The price estimates required by the Coalition are based on the PRISMOD Economic Modeling System. This system has been criticised by economists and in the senate as being conservative. Actual price increases after 1 July 2000 may be greater than those estimated.
3. The modeled outcomes in the Coalition's policy document are already out of date as a result of the changes to the GST package brought about by negotiations between the Government and the Democrats. It is uncertain what effect these changes will have on inflation and CPI.

An important element of personal injury claims in which the effect of GST must be established is in respect of *Griffiths v Kerkemeyer* claims. In *Griffiths v Kerkemeyer* (1977) 139 CLR 161 Mason J said at 193 that "...in general, the value or cost of providing voluntary services will be the standard or market cost of services". Accordingly, the impact of the tax reform changes will be calculated by establishing the "standard or market" cost of the relevant services and then determining how the GST and other tax reform changes will alter the cost of those services.

### GST impact on court orders and out of court settlements

As noted above, GST is a tax on "supplies" and a "supply" is defined to include not only goods and services but other

things as well eg. real property, a surrender of a right, a release from an obligation "to do anything or to refrain from an act or to tolerate an act or situation ..." (see section 9-10 of the GST Act).

In the case of a plaintiff receiving either an out of court settlement or a court ordered damages or compensation payment, the receipt of this payment by the plaintiff is more than likely correctly identifiable as consideration for a "supply" for GST purposes. However, as noted above, a supply is only subject to GST if it is a taxable supply. Accordingly, in determining whether or not the receipt of damages is a taxable supply, the facts of each particular case must be considered.

**"...a supply is only subject to GST if it is a taxable supply."**

### Private consumers

In the case of plaintiffs who are private consumers, including employees and members of the public not carrying on an enterprise, damages received by these private individuals would be outside the scope of the GST as such settlements would not satisfy the ele-

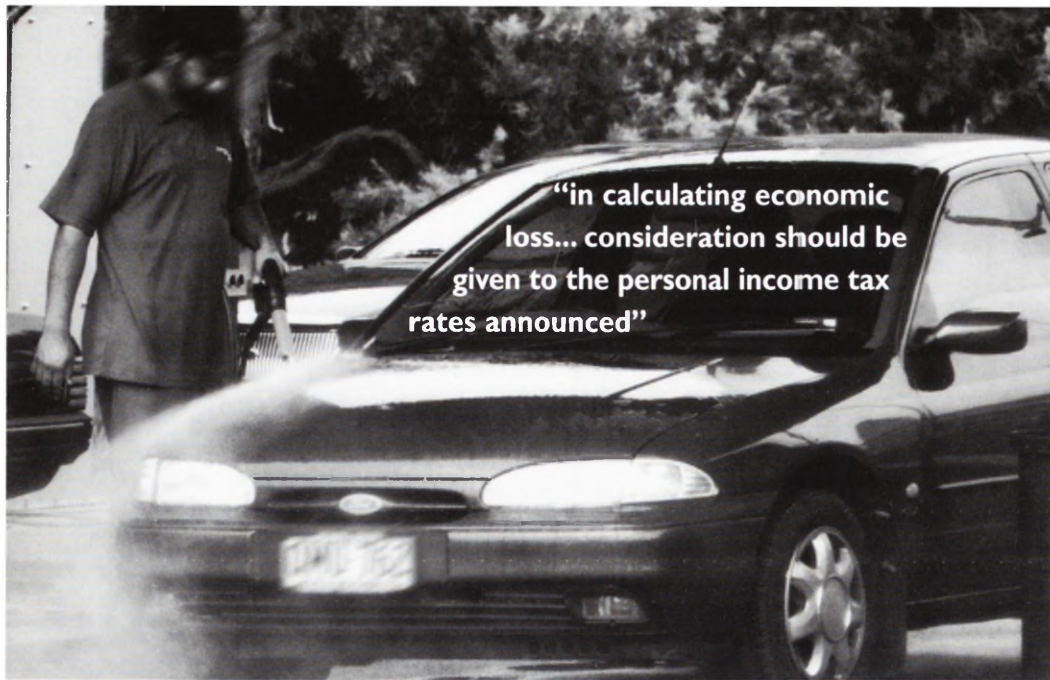
ments of a taxable supply as contained in section 9-5 of the GST Act. Further, in the Explanatory Memorandum accompanying the amendments to the GST provisions dealing with insurance settlements, Division 78, it is noted that "they (private consumers) do not have a GST liability on settlement..." (page 46 of the Explanatory Memorandum to *A New Tax System (Indirect Tax and Consequential Amendments) Bill (No.2) 1999*).

### Persons carrying on an enterprise

There are two categories of supplies (i.e. payments) to be considered under this heading.

#### (i) DAMAGES AWARDED – INSURER PAYS CLAIM

It is important to note that the GST Act includes Division 78 which has specific provisions dealing with settlements under insurance claims. The position with settlements paid under insurance claims is explained in the above mentioned Explanatory Memorandum and the following example is given at page 44:



"A registered business, Angela's Automatic Car Wash ("AAC"), acquires an insurance policy fully for a creditable purpose. The GST inclusive price of the policy is \$385. AAC causes personal injuries to a customer when the automatic car wash malfunctions. The damages are \$50,000.

AAC is entitled to a \$35 input tax credit on the insurance policy under Division 11 of the GST Act. It has no GST liability on settlement of the claim [new section 78-45].

The insurer has a \$35 GST liability on the supply of the insurance policy under Division 9 of the GST Act. The settlement under the policy is not treated as consideration for an acquisition made by the insurer [new section 78-20]. In this instance the insurer does not have a decreasing adjustment because AAC was entitled to a full input tax credit on the premium.

The total settlement will be the \$50,000 paid to the injured customer. The cost of the claim to the insurer is \$50,000."

As can be seen in the above example, there is no GST liability in settlement of the claim ie. there is no GST payable by any party in respect of the damages award of \$50,000.

**(ii) DAMAGES AWARDED – NO INSURANCE CLAIM**

Other than Division 78 which deals with settlements paid by insurers, there are no specific provisions in the GST Act dealing with damages paid to a plaintiff by a defendant where the claim is not covered by an insurer.

Accordingly, the GST impact of payments received by a plaintiff must be considered under the general provisions of the GST Act. In particular, section 9-5 of the GST Act must be considered to determine whether or not there is a taxable supply in relation to damages received by a plaintiff.

Under section 9-5 there can only be a taxable supply if "the supply (was) for consideration". It is then necessary to consider the meaning of "consideration" which is defined in section 9-15 as follows:

**"9-15 Consideration**

- (1) *Consideration* includes:
  - (a) any payment, or any act or forbearance, in connection with a supply of anything; and
  - (b) any payment, or any act or forbearance, in response to or for the inducement of a supply of anything.
- (2) It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the \*recipient of the supply.
- (3) However:
  - (a) if a right or option to acquire a thing is granted, then:
    - (i) the consideration for the supply of the thing on the exercise of the right or option is limited to any additional consideration provided either for the supply or in connection with the exercise of the right or option; or
    - (ii) if there is no such additional consideration – there is no consideration for the supply; and

- (b) a payment made as a gift to a non-profit body is not the provision of consideration; and
- (c) a payment made by an \*Australian government agency to another Australian government agency is not the provision of consideration if the payment is specifically covered by an appropriation under an \*Australian law.

However, the recently inserted subsection provides that:

**9-15(2A) 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 which 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 ..."

In relation to settlements received by plaintiffs, the effect of subsection 9-15(2A) is explained in the Explanatory Memorandum which makes it clear that not all payments of compensation or damages will be subject to GST. In particular, the payment will only be subject to GST where that claim relates to a taxable supply of goods or services.

The example given in the Explanatory Memorandum is for money received as a result of a court order for non-payment of a taxable supply. This will be regarded as "consideration" for a supply and subject to GST. In these circumstances, where a business sued a customer for non-payment of a taxable supply and received damages as a result of this claim then these damages would be subject to GST. On the other hand, in the case of the example given above in relation to Angela's Automatic Car Wash, in the absence of an insurance claim, it may be concluded that there is no GST on the damages of \$50,000 as the settlement received is not a result of the non-payment of a taxable supply but rather as compensation for injuries caused to a customer, albeit in the course of provid-

ing a taxable supply to that customer. The position would be different if Angela's Automatic Car Wash was suing the customer for non-payment of the cost of the car wash and any damages awarded for a claim of this nature would clearly be for the non-payment of a taxable supply and subject to GST.

### **Solicitor/client costs and party/party costs**

Solicitor/client costs are those costs paid by the defendant to the plaintiff at the conclusion of proceedings. Party/party costs are those costs paid by each party and outside the scope of compensation/damages paid to the plaintiff. For example, a successful plaintiff may still be liable to pay a portion of her/his legal fees and other costs incurred by the solicitor in preparing the plaintiff's case.

In relation to costs generally, they will have a 10% GST component in the case of taxable supplies eg. legal fees, investigating accountant's reports, private investigator's reports etc and no GST component in the case of qualifying GST-free supplies eg. medical services.

The following issues arise under the GST legislation in relation to costs generally.

### **Input tax credits**

As indicated in Part A of this paper, an enterprise, such as a firm of solicitors acting for a plaintiff in a personal injury matter ("the firm"), may be entitled to claim input tax credits in respect of GST included in the price of supplies to the firm. For example, in the case of the firm purchasing a computer system after 30 June 2000 for exclusive business use, there would be an entitlement to claim the GST included in the price of the computer as an input tax credit when it pays its GST to the Tax Office. The question of input tax credits will arise in the case of third party costs incurred by the firm in preparing the plaintiff's case. The entitlement of the firm to claim input tax credits will depend on whether the firm incurs the costs in its own right or whether as mere agent of the plaintiff. There will be no entitlement to input tax credits to the firm where it acts as an agent of the

plaintiff for the reason that the supply is not acquired by the firm but by the firm's client, namely, the plaintiff.

### **Transitional issues**

GST commences on 1 July 2000 and does not apply to supplies made before this date. For example, consider a solicitor who has incurred professional costs prior to this date and has not invoiced these costs to a client by 1 July 2000. As these costs relate to services performed prior to the commencement of GST, section 6 of the GST Transition Act ensures that there is no liability for GST on such "work in progress". Further, any other costs which the solicitor may bill in relation to services performed prior to 1 July 2000 but invoiced after this date will also not be subject to GST.

### **The effect of GST on economic loss damages**

In assessing economic loss claims, the effect of GST and the other tax reforms will depend upon the circumstances of each plaintiff.

The introduction of GST is only part of the Government's overall tax reform plans and in considering economic loss claims, all the new tax reforms must be taken into account.

In *Tax Reform: Not A New Tax, A New Tax System*, the Government described the "priorities principles and features" of the New Tax System as follows:

- "That there should be no increase in the overall tax burden;
- That any new taxation system should involve major reductions in personal income tax with special regard to the taxation treatment of families;
- That consideration should be given to a broad-based indirect tax to replace some or all of the existing indirect taxes;
- That there should be appropriate compensation for those deserving of special consideration; and
- That reform of Commonwealth-State financial relations must be addressed."

The Government then stated in this publication that "the New Tax System set out in this document fulfils all of

these principles, and does so through simpler and fairer arrangements..."

In addition to the introduction of GST, the Government announced that there would be major cuts to personal income tax, reductions in company tax, the removal of a range of State taxes (e.g. bed taxes and financial institutions duty) and the removal of the wholesale sales tax to take effect from 1 July 2000.

In calculating economic loss claims, consideration should be given to the personal income tax rates announced by the Government in August 1998, as follows:

- An increase in the tax-free threshold from \$5,400 to \$6,000;
- A reduction in the lowest marginal tax rate from 20% to 17%;
- A lower tax rate of 30% for people in the \$20,701 to \$50,000 taxable income bracket (currently 43% at taxable incomes between \$38,001 - \$50,000); and
- A \$10,000 increase in the level of taxable income at which the top marginal tax rate of 47% takes effect.

In relation to the GST, the overall scheme of the GST legislation is to ensure that the GST is passed on by businesses to the private consumer. This should ensure that with the introduction of GST there should be a neutral effect on business.

In addition to the tax reform changes, associated costs with the tax reforms may emerge which may need to be taken into account when considering economic loss claims. Some of these costs are as follows:

- Compliance costs incurred by business in meeting their obligations under the new tax system eg. costs incurred in collecting and remitting GST to the Tax Office; and
- The impact of the tax reform changes on business profits which may arise due to pricing changes to adjust to tax reform and compliance with guidelines on pricing issued by the ACCC.

The tax reform changes, including GST, must be taken into account when calculating economic loss claims but their full impact may not be known until the changes are introduced, commencing on 1 July 2000. ■