

1 June 2011

**DEREK S FIRTH**

Barrister, Arbitrator, Mediator, Adjudicator  
Fellow, The Arbitrators' and Mediators' Institute of NZ

Telephone No: (09) 307 9129, Mobile: 021 933 747  
Box Number 105392, Auckland City 1143, New Zealand  
Email: dsfirth@ihug.co.nz

**ADJUDICATIONS UNDER THE CONSTRUCTION CONTRACTS ACT 2002  
GST ISSUES**

**GENERAL PRINCIPLES**

Under section 8 of the GSTA, GST is charged on supplies made by a registered person in the course or furtherance of their taxable activity, by reference to the value of that supply.

Under section 6 (1) (a), a taxable activity is one that is carried on "continuously or regularly".

"Supply" is defined in section 5 as including "all forms of supply".

"Consideration" is defined in section 2:

**Consideration, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body.**

The "value of supply" is defined in section 10 (2) as the amount of the money if the consideration is money, or the open market value of the consideration if the consideration for the supply is not consideration in money.

Section 10 (18) contemplates apportionment of a payment where it only partly relates to a taxable supply.

These provisions have been the subject of a number of cases, some of which are to be found in the *Inland Revenue Department Tax Information Bulletin: Volume 14, No 10 (October 2002)*.

**COURT AWARDS, INCLUDING ARBITRATION AWARDS AND ADJUDICATION DECISIONS, AND OUT OF COURT SETTLEMENTS**

The appropriate focus is whether the award is payment for any supply that has been made, and not the action that gave rise to the award.

Every transaction must be analysed upon its own individual facts relating to supply and consideration.

When a payment is made under an award or out of court settlement and it is consideration for a taxable supply (or an adjustment to a consideration for a taxable supply) this will be taxable.

If the payment is made for compensation or damages, it is not taxable. Sometimes a different result can arise from the same facts, but depending upon the claim which is made and the remedy approved. For example, an award for general damages for loss resulting from receiving goods of lesser quality than was promised is not subject to GST. However, if the claimant brought a claim (arising out of the same facts) pursuant to section 43 (2) or the Fair Trading Act on the basis of lack of merchantable quality, and a refund is ordered then there will need to be a GST adjustment if the tax on the full price has already been paid.

The short point is that, where damages are awarded for a loss, the nexus of the payment (for GST purposes) is with the loss, rather than the supply that gave rise to the damages claim and there is therefore no GST on the amount awarded.

### **QUANTUM MERIT**

Awards of quantum merit are made where something of value has been provided by one party in the absence of formal contractual relations. If an award is made for quantum merit, then the payment awarded will be consideration for a supply.

Where restitution is received by a party that made a supply (in the course or furtherance of a taxable activity) the payment will be consideration for a supply and therefore be subject to GST. (*Seton Contracting Limited v Attorney-General* [1982] 2 NZLR 368.)

### **PAYMENT AWARDED FOR CONTINUING WRONG**

If an award is made under section 16 A of the Judicature Act 1908 and, for example, rewards the owners of land against a local authority, a sum based on the amount they could reasonably expect if the council had agreed to pay for the use of the land, then the payment is damages and not consideration for any supply.

### **AWARDS IN RESPECT OF LOSS**

As was stated in the decision of the High Court of Australia in *Haines v Bendall* (1991) 172 CLR 60, 63 (and approved by Cooke P in *Gardiner v Metcalf* [1994] 2 NZLR 8 (Court of Appeal)):

**The settled principle governing the assessment of compensatory damages, whether in actions of tort or contract, is that the injured party should receive compensation in the sum which, so far as money can do, will put that 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 ...**

Compensatory damages, being awarded for loss, are not subject to GST. GST is imposed as a tax on goods and services supplied rather than on payments received.

It is the legal nature of a transaction, not its economic effect, that determines liability to tax. (*Marac Life Assurance Limited v CIR* [1986] 1 NZLR 694 at 706.)

The payment cannot be consideration for a supply if it is not reciprocal to the supply of something by the other party. In relation to court and arbitration awards, and adjudication determinations, where a payment is for loss or damage it will not be consideration for a supply and there will be no element of reciprocity between the parties in regards to the payment; rather, the payment is to compensate one party for the loss caused by the wrongful act of the other.

## **GST ON COSTS**

It is necessary to consider the different situations in which this issue arises.

- Costs of lawyers and experts.
- Costs of adjudicator.
- Costs where the receiving party (who has paid the costs) has or will recover the GST compared with a home owner who may not be able to do so.

In *Adcock & Devir v Marlborough District Council* (2011) 25 NZTC 20 – 029, Judge McElrea discussed the situations where GST could be included in costs awards in the Environment or District Courts.

It is important to avoid over-recovery. He referred to the decision of Winkelmann J in *Suttie v Bridgcorp Limited* HC Auckland CIV-2006-404-3667, 8 December 2006. Her Honour said, in that decision, that a party who is GST registered and who has deducted its legal costs as an input for GST purposes as they were incurred, would be over-recovering if it received back all of its costs paid.

That is certainly the view which I have adopted over many years and I think the position can be summarised as follows:

- Costs of lawyers and experts should not include the GST if the person receiving the costs (ie who has incurred them) will have or be able to recover the GST.
- It may not matter if GST is included provided there is no windfall or double-recovery to either side.
- However, where the party receiving costs is not registered for GST (for example, a home owner in a building dispute) then the GST should be included in the costs recoverable because that is part of the cost which the home owner has incurred and cannot recover from elsewhere.

## **GST ON DAMAGES**

The normal rule is that damages do not attract GST.

Examples would be damages for delay, regardless of whether they are liquidated damages or general damages.

However, where the damages have been assessed on the basis of taxable supply, then GST must be recovered as well.

For example, damages reflecting the cost of incomplete work or remedial work.

## **GST ON INTEREST**

There is no GST on interest.