1. **Statement**

This Standard assist in determining tax codes for out of court settlements.

2. **Scope**

Compliance with this standard is mandatory.

This standard shall apply to all employees, contractors and consultants within the Department of Health divisions and commercialised business units as well as Hospital and Health Services.

3. **Requirements**

**Introduction**

There is the potential for a GST liability to arise as a consequence of receiving or paying a court order or an out-of-court settlement.

The GST consequences of a court order or out-of-court settlement will depend on whether there is a “supply” for the purposes of the GST Act. Another aspect to consider is, whether the “supply” is “in the course of furtherance of an enterprise”. The supply may be taxable, input-taxed or GST-free.

As medico-legal claims could be identified as the majority of claims for Queensland Health (QH), advice has been obtained from the Crown Solicitor regarding the impact of GST on these claims against QH. This has been communicated to those firms on QH's Medico-Legal Panel. Contact details for the Medico-Legal Panel including names of the client liaison partner and the lawyers within the firm who have been approved as nominated lawyers to undertake work for QH, are contained in Schedule 5 of the Legal Services Guidelines available on QHEPS. These client liaison partners should therefore be in a position to address any specific queries districts may have in this regard.

**Summary of Tax Codes**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tax Code Sale</th>
<th>Tax Code Purchases</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Queensland Health Expenditure – Court Orders &amp; Out of Court Settlements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment for <strong>taxable supplies previously made</strong> to QH (“earlier” supply – the supply occurred before the dispute arose) with compliant tax invoice and when other requirements for a taxable supply are met</td>
<td></td>
<td>P0</td>
</tr>
<tr>
<td>Payment for a <strong>taxable supply for something new</strong> to QH (“current” supply – QH agrees to allow something to start happening after the court order) with compliant tax invoice and when other requirements for a taxable supply are met</td>
<td></td>
<td>P0</td>
</tr>
<tr>
<td>Above examples, “earlier” and “current”, supply by a non-registered entity</td>
<td></td>
<td>P5</td>
</tr>
<tr>
<td>“Earlier” or “Current” supply that is provided to QH and is GST-Free</td>
<td></td>
<td>P5</td>
</tr>
<tr>
<td>Description</td>
<td>Tax Code Sale</td>
<td>Tax Code Purchases</td>
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<tr>
<td>-----------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>“Earlier” or “Current” supply that is provided to QH and is Input Taxed (e.g.</td>
<td></td>
<td>P1</td>
</tr>
<tr>
<td>supplies relating to QH residential properties such as repairs &amp; maintenance)</td>
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<td></td>
</tr>
<tr>
<td>Medico-legal claim on QH</td>
<td></td>
<td>P9</td>
</tr>
<tr>
<td>(not made in the course of furtherance of an enterprise)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Settlement of claim for damages or compensation</td>
<td></td>
<td>P9</td>
</tr>
<tr>
<td>(does not in itself constitute “a supply” under the GST Act)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plaintiff’s Legal costs (may show GST inclusive costs - supply of legal</td>
<td></td>
<td>P9</td>
</tr>
<tr>
<td>services is to plaintiff not QH)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Queensland Health Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment made to QH for taxable supplies previously made to QH</td>
<td></td>
<td>S0</td>
</tr>
<tr>
<td>(“earlier” supply – the supply occurred before the dispute arose) with</td>
<td></td>
<td></td>
</tr>
<tr>
<td>compliant tax invoice and when other requirements for a taxable supply are</td>
<td></td>
<td></td>
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<tr>
<td>met.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment made to QH for a taxable supply for something new to QH</td>
<td></td>
<td>S0</td>
</tr>
<tr>
<td>(“current” supply – QH agrees to allow something to start happening after</td>
<td></td>
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</tr>
<tr>
<td>the court order, e.g. sharing of a trade name) with compliant tax invoice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>and when other requirements for a taxable supply are met</td>
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</tbody>
</table>

For further information on determining GST treatment refer to the Decision Tree for GST (included at the end of this GST Business Procedure). This is an extract from GSTR 2001/4.

**Application to Queensland Health**

Given the broad definition applied to both supply and consideration in the GST legislation and in Case Law within Australia and abroad, it is likely that GST will be applicable to most court orders and out-of-court settlements reached in relation to commercial activities.

However, in the case of QH, most of the legal disputes centre on claims for damages resulting from negligent type actions. Clearly, these settlements are unlikely to arise in the course of the furtherance of an enterprise and therefore, there will not be a taxable supply and GST will not apply. It should be noted that although many QH settlements will not explicitly incur a GST levy, the overall claim for damages may still increase as a result of the new tax system.

Further information on insurance settlements can be obtained by referring to the GST Business Procedures – The Queensland Government Insurance fund (QGIF), available on QHEPS.

**Taxable Supplies**

An out-of court settlement or court ordered compensation payment may be treated as consideration for a supply. In accordance with the normal rules, that supply may therefore be taxable if:

- The plaintiff is registered (or required to be registered for GST)
- The supply is made in the course of carrying on the plaintiff’s enterprise
- The supply is connected with Australia
- The supply is not GST-free or input taxed
• The supply is made on or after 1 July 2000

Consideration

GST is not payable on supplies unless they are made for consideration. As well as payment (money), consideration also covers situations where someone does something or refrains from doing something. Any of these things are treated as consideration for a supply if they are:

• Connected to the supply,
• Made in response to the supply, or
• Made to induce the supply

The consideration must clearly be in relation to the supply. That means that there must be a sufficient nexus between the supply and the payment, act or forbearance.

Categories for Out-of-court Settlements and Court Orders/Awards

Supplies relating to an Out-of-Court Settlements and Court Orders may fall within the following categories:

Earlier supply: the GST Act requires the identification of a supply before there is any GST payable. In some disputes, the supply may have already occurred and the subsequent settlement therefore relates back to that supply. This type of supply is known as an “earlier” supply.

For example, QH enters into an out-of-court settlement with a private hospital for recovery of amounts outstanding for the supply of patient meals. The supply of the meals is an earlier supply because it occurred before the dispute arose. If the other requirements for a taxable supply are met (see section “Taxable Supplies” above), GST will apply and can be coded to:

**P0 – Subject to GST @ 10%**

Current supply: this is where under the terms of the settlement one party agrees to provide the other with something new. For example, in a dispute between QH and a Private Provider over the use of a trade name (e.g. Oral Health) if the subsequent settlement allowed the Private Provider to use the trade name in the future, this would constitute a current supply. In this case, if the other requirements for a taxable supply are met (see section “Taxable Supplies” above), GST will apply and the appropriate tax code would be P0.

P0 (expenditure by QH) and

S0 (revenue received by QH) – Subject to GST @ 10%

Supply relating to discontinuance of action: even without an earlier or current supply, a supply is still likely to exist because most settlements involve undertakings by one or more of the parties to discontinue action in relation to the dispute. For example, in the circumstance of the settlement of a medico-legal claim there would be a supply but that supply would not be in the course of furtherance of an enterprise and should be coded to:

**P9 – Out of scope**
Court imposed terms: when a matter is ultimately resolved by a court, the terms are imposed by the court, not reached by agreement between the parties. Here the court itself has not made a supply. However, the resultant outcome may be a supply between the parties.

If a sufficient nexus between the supply and the consideration can be made, then an examination of the type of supply being made will need to occur i.e. taxable supply, GST-Free supply or Input Taxed Supply. Thought must also be given to the registration status of the supplier i.e. whether the supplier is registered for GST or not. All of these factors would have a bearing on the appropriate tax code to be used.

Where the settlement is not a taxable supply

Where a court order or out-of-court settlement finalises a claim for damages or compensation, (e.g. property damage, negligence causing loss of profits or personal injury) the damages or loss, being the substance of the dispute, does not in itself constitute a supply under the GST Act.

In the case of an out of court settlement, the supply would be the obligation the injured party has entered into to refrain from taking further action in relation to the dispute.

Impact of GST on Medico-Legal claims

Medico-legal claims (which are a form of personal injury action) comprise the large majority of litigation claims against QH. The GST position on out-of-court settlements and court orders/awards in relation to these claims is as follows:

Out of court settlements

The settlement of a medico-legal claim, which is generally reflected in a Deed of Settlement, does constitute a supply under the GST Act because the injured party (plaintiff) enters into an obligation to refrain from taking further action.

Payment of the settlement sum by QH represents consideration for the supply made by the plaintiff. However, it is not a taxable supply because it is not made in the course or furtherance of an enterprise.

Accordingly, the settlement of the claim and therefore the settlement sum paid by QH does not attract GST and consequently, no input tax credits will be available to QH. This also applies to any of the plaintiff’s legal costs. The appropriate tax code to use is –

P9 – Out of scope

Court orders/awards - There is no particular distinction between out-of-court settlements and court awards when considering the impact of GST on medico-legal claims. The principles that apply to settlements also apply to court orders/awards. Therefore, GST is not payable on a total damages award ordered by a court in respect of a medico-legal claim. The appropriate tax code to use is –

P9 – Out of scope

Individual components of a damages claim - The total sum paid by QH in settling a medico-legal claim or pursuant to a court order/award will not attract GST. However, it may be that a particular component of the plaintiff’s claim (whether set out in a Deed of Settlement or awarded by a court), increases as a result of GST.
One example is “future care”. A plaintiff may seek compensation for domestic care to be provided to the plaintiff through commercially acquired professional services. The cost of these services will have increased to accommodate the imposition of GST. Therefore, a plaintiff may seek to recover the increased cost as part of their overall damages claim. The settlement of the claim should be coded to –

**P9 – Out of scope**

Plaintiff’s legal costs - It may be that pursuant to an out of court settlement of a claim or a court order or award, QH agrees, or is ordered to, reimburses the plaintiff in respect of their legal costs. These costs are likely to include GST. However, QH is not entitled to claim an input tax credit for the GST component, irrespective of whether a tax invoice (or a copy thereof) is provided by the plaintiff or their solicitors.

The rationale is that QH is simply reimbursing the plaintiff for an expense they have incurred, and is not making a “creditable acquisition” for the purposes of the GST Act. The supply of these legal services is to the plaintiff not QH.

Note: Where these costs have been clearly identified and an invoice or other relevant documentation has been provided, the payment should be processed using the following tax code:

**P9 – Out of scope**

Payment of a Court Judgment, damage claim and full settlement amount should also be coded to:

**P9 – Out of scope**

**Assessing the liability**

Normal GST rules will apply when assessing the liability, i.e. for an entity operating on accruals such as QH, the GST payable should be attributed on the consideration for the supply in the tax period in which an invoice is issued, or any consideration received whichever is the earlier.

Where the settlement consideration is made up of a taxable and non-taxable supply, the GST liability will need to be apportioned. The apportionment should be determined on a reasonable and objective basis. For example, in a copyright case, the settlement consideration of $200,000 consisted of $50,000 damages for breach of copyright and $150,000 for the use of copyright material.

Here a reasonable approach would be to assess GST only on the $150,000 because the $50,000 is payment for damages and does not constitute a supply. An alternative might be to assess the $200,000 based on some industry standards for paying copyright.

Even in cases where there is no explicit GST liability, it is still likely that the amount of future claims made will increase owing to the effect of the GST on market conditions. For example, in damages cases where the plaintiff is suing for loss of future income, it is estimated that the amount could increase between 3% and 17% depending on the plaintiff’s tax bracket because of the tax cuts associated with the introduction of the new tax system and changing taxable income thresholds and rates of income tax.
Decision Tree for GST (From GSTR 2001/4)

Dispute

Resolution by court order or out-of-court settlement

Does a supply exist?

No

No GST Liability

Yes

Payment Act or forbearance

Yes

Is there a link or Nexus?

Yes

Then there is consideration

Is the consideration for

an earlier supply?

Yes

May be Adjustment event for recipient

No

A taxable supply?

Yes

No GST Liability for recipient

A GST-free supply?

Yes

An input taxed supply?

Yes

Basic GST principles apply
4. Related legislation and documents

- A New Tax System (Goods and Services Tax) Act 1999
- ATO Ruling GSTR 2001/4 - GST Consequences Of Court Orders And Out-Of-Court Settlements
- GST Business Procedure – Insurance

5. Definitions

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>GST Act</td>
<td>A New Tax System (Goods and Services Tax) Act 1999</td>
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Version Control

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