TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTOTANGA WHAKATAU Ā-TURE > WHAKAWĀ

Whether weathertightness payments by the Crown are subject to GST

Decision date | Te Rā o te Whakatau: 6 May 2022

Issue date | Te Rā Tuku: 25 October 2022

TDS 22/19

Subjects | Ngā kaupapa

GST: grants and subsidies

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

GSTA	Goods and Services Tax Act 1985
GST	Goods and Services Tax
Commissioner	Commissioner of Inland Revenue
WHRS Act	Weathertight Homes Resolution Services Act 2006
FAP	Financial Assistance Package scheme under the WHRS Act
Council	The local council
Council FAP Payments or Crown FAP Payments	Payments made under the Financial Assistance Package scheme by the local council or Crown
TCO	Tax Counsel Office, Inland Revenue
MBIE	Ministry of Business, Innovation and Employment
CCS	Customer and Compliance Services, Inland Revenue

Taxation laws | Ngā ture take

Goods and Services Tax Act 1985

Facts | Ngā meka

1. The Taxpayer is a GST registered body corporate providing services to the unit owners in an apartment complex. These services include repairing and maintaining the complex. The complex suffered weathertightness issues that required extensive remedial work.
2. The Taxpayer and unit owners lodged a claim under the Weathertight Homes Resolution Services Act 2006 (**WHRS Act**) and also commenced High Court proceedings against the local council (**Council**) and others they considered

responsible for the defects. The Crown was not a party to the proceedings. In 2015 the parties to the proceedings entered a settlement agreement under which the Taxpayer and unit owners agreed to proceed with obtaining Government Financial Assistance Package (**FAP**) scheme under the WHRS Act.

3. Subsequently, the Taxpayer, the Crown (acting by and through the Ministry of Business, Innovation and Employment (**MBIE**)) and the Council entered the FAP Agreement. The FAP Agreement included obligations and acknowledgements that:
   - MBIE and the Council each agreed to pay 25% of the approved remedial costs – which does not include costs that result in betterment.
   - once the first payment is made s 125G of the WHRS Act applies to restrict civil proceedings and relief.
   - MBIE may act as the Council's agent to pay the Council's payments in accordance with the FAP Agreement.
   - there is no admission of liability by MBIE and/or the Council.
4. Subsequently, MBIE made payments under the FAP Agreement to satisfy the Crown's payment obligations (**Crown FAP Payments**) and those of Council (**Council FAP Payments**) as the Council's agent. For reasons that are unclear, the total Crown FAP Payments were greater than the total Council FAP Payments. The Taxpayer distributed an amount to unit owners in late 2019 as a refund for levies not required because there was no further work to be done or paid for. The Taxpayer filed GST returns on the basis that the Crown FAP Payment was not subject to GST.

Issues | Ngā take

5. The issue considered in this dispute was:
   - whether the Crown FAP Payments received by the Taxpayer were "payments in the nature of a grant or subsidy" under s 5(6D) and therefore, deemed consideration for a supply that is subject to GST under s 8.
6. The GST treatment of the Council FAP Payments to the Taxpayer was not in issue.

Decisions | Ngā whakatau

7. TCO decided that:
   - The Crown FAP Payments to the Taxpayer are gratuitous payments to encourage or promote the repair of leaky buildings. The payments have not been made for

the Taxpayer's personal use or benefit, or for the personal use or benefit of a relative of the Taxpayer. Accordingly, the payments are in the nature of a grant or subsidy for the purposes of s 5(6D) of the Goods and Services Tax Act 1985 (**GSTA**). The Crown FAP Payments are therefore deemed to be consideration for a supply under s 5(6D), and subject to GST under s 8, of the GSTA.

- To the extent the difference between the Crown FAP Payments and the Council FAP Payments is because the Crown has funded any part of the Council's obligations under the FAP Agreement, the relevant amount would be a settlement or compensation payment rather than a payment in the nature of a grant or subsidy for the purposes of s 5(6D).

Reasons for decisions | Ngā take mō ngā whakatau

Issue | Take: Whether the payments are in the nature of a grant or subsidy for the purposes of s 5(6D)

8. The issue was whether the payments received by the Taxpayer were a "payment in the nature of a grant or subsidy" under s 5(6D). If they were, then there is a deemed supply for consideration and the payments will be subject to GST.

9. Customer and Compliance Services, Inland Revenue (**CCS**) argued s 5(6D) applied because the Crown FAP Payments were made without obligation to assist the Taxpayer to repair the property and this benefits both the Taxpayer and the wider public. CCS argued the exclusions (in s 5(6E)) to the term "payment in the nature of a grant or subsidy" did not apply.

10. The Taxpayer argued the Crown FAP Payments were not payments in the nature of a grant or subsidy and s 5(6D) did not apply. The payments, whether Crown or Council funded, arose under the FAP Agreement and were, in form and substance, payments to settle any legal liability of the Crown and of the Council. The payments were not made to assist or enable the Taxpayer to provide goods and services considered of public benefit in accordance with any Government objective. Further, it was argued that the payments were in any case for the personal use and benefit of the Taxpayer and its owners and so the exclusion from being a payment in the nature of a grant or subsidy in s 5(6E) applied.

11. Section 5(6D) deems any payment in the nature of a grant or subsidy made on behalf of the Crown to any person in relation to or in respect of their taxable activity to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made. The supply is deemed to be in the course or furtherance of that person's taxable activity.

12. The key requirements for s 5(6D) are that there is a payment:
    - in the nature of a grant or subsidy
    - made on behalf of the Crown or by any public authority
    - made to a person (not being a public authority)
    - made in relation to or in respect of that person's taxable activity.
13. The issue to be considered was the first bullet point – whether the payments were in the nature of a grant or subsidy. Included in this consideration was whether the specific exclusion for personal use payments and benefits in s 5(6E) applied.

Payments in "the nature of a grant or subsidy" for the purposes of s 5(6D)

14. At the time s 5(6D) was enacted the guidance noted that the common thread in the definitions of grant or subsidy is that there "is a gift or assignment of money by government or a public authority out of public funds to a private or individual or commercial enterprise deemed to be beneficial to the public interest."[1]
15. Case law indicates the focus is on the character of the payment from the payer's perspective, not its receipt in the hands of the payee, and recognises that a subsidy payment changes the nature of a contract from an ordinary commercial contract.[2] The Commissioner's previously published public guidance[3] has considered factors which may indicate that a payment is in the nature of a grant or subsidy, including where the payment is:
    - a gift, in the sense that there is no obligation to make it
    - a special assistance payment
    - to promote or encourage an industry or enterprise
    - out of public funds
    - beneficial to the public interest.

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[1] Commissioner's public statement: "Application of GST to Government Grants and Subsidies" (*Tax Information Bulletin* Vol 3, No 1 (July 1991)). This wording is from the Canadian case, *GTE Sylvania Canada Ltd v R* [1974] 1 FCR 726.

[2] *Kena Kena Properties Limited v Attorney-General* (2002) 20 NZTC 17,433 (PC); *Director-General of Social Welfare v De Morgan and anor* (1996) 17 NZTC 12,636 (CA).

[3] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)) and Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

16. In summary, it was considered that the case law indicates a payment in the nature of a grant or subsidy is a gratuitous payment made by the Crown, out of public funds, to promote or encourage an industry or enterprise and that the payment is special assistance, beneficial to the public interest.[4]

17. The Taxpayer argued that the Crown FAP Payments were not the sort of payments Parliament envisaged as being subject to GST as payments in the nature of a grant or subsidy. Consequently, TCO considered the legislative background and concluded that the Government's intention was that GST would be payable on grants and subsidies received by a registered person in the course of their taxable activity. The recipients of these grants are supplying services to the Crown through the use to which they put the grant money they receive and the purpose of s 5(6D) is to make such payments subject to GST.

18. TCO concluded that the Crown FAP Payments were in the nature of a "grant or subsidy" because:

- The payments were gratuitous payments by the Crown for the purpose of assisting with the cost of repairing the Taxpayer's property to remedy problems arising from it not being weathertight. The payments were gratuitous because they were not made in response to any duty of care owed to the Taxpayer or unit owners.[5]
- The FAP Agreement does not acknowledge or otherwise create a duty of care and does not represent an admission of any form of liability by the Crown to the Taxpayer.
- The Crown FAP Payments are special assistance payments, deemed to be beneficial to the public interest.
- To the extent it is necessary to conclude that the Crown FAP Payments are beneficial to the public interest, or enable the Taxpayer to provide services to members of the public at a concessionary price, this criterion has been satisfied. This is because it is in public interest that these properties remain habitable by the homeowner and other New Zealanders in the future, and the homeowners were able to have their units repaired at a reduced cost.

[4] *Kena Kena Properties Limited*; *De Morgan* (CA); *De Morgan and Anor* (1996) 17 NZTC 12,441 (HC); *Reckitt & Colman Pty Ltd v FCT* 4 ATR 501; *First Provincial Building Society Ltd v FCT*; *Case Q13* (1993) 15 NZTC 5,078 and *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353.

[5] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95 supports the view there is no duty of care on the Crown.

Payments for personal use or benefit of a person excluded under s 5(6E)

19. Under s 5(6E), a payment will not be in the nature of a grant of subsidy for the purposes of s 5(6D) if the payment is "for the personal use and benefit of the person or, as the case may be, a relative (as defined in paragraph (a) of the definition of that term in section YA 1 of the Income Tax Act 2007) of the person".[6]

20. TCO considered that the exclusion in s 5(6E)(b)(ii) does not apply to the Crown FAP Payments because:

- The Taxpayer is not a person for the purposes of s 5(6E)(b)(ii). The definition of "person" in s 2 of the GST Act includes companies and applies "unless the context otherwise requires". In the context of s 5(6E)(b)(ii) it was considered that the term refers only to a natural person (ie, not a company). The subsection excludes payments for the personal use and benefit of the recipient person or a "relative" of the person. It was concluded that only a natural person can personally use a grant or subsidy. This position finds some support in the use of the term "relative" in the subparagraph. In any event, the Taxpayer cannot use the Crown FAP Payments personally as it is restricted in how it can use funds by legislation.
- The IRD guidance that sets out the purpose of s 5(6D) and (6E)[7] supports this conclusion. The Crown FAP Payments are not benefits similar to those paid under the Social Security Act (such as family support tax credits), which can be used by the recipient (who, given the nature of the payments, will be a natural person) for whatever purpose the recipient desires.
- TCO did not agree with the argument that s 5(6E)(b)(ii) applies to the Crown FAP Payments because some of the 'settlement monies' were ultimately distributed to the unit owners to use as they wished. The Crown FAP Payments were paid to the Taxpayer. The amounts distributed to the unit owners by the Taxpayer were not a distribution of the Crown FAP Payments but rather, as described on the credit notes distributed, a refund of levies (previously paid by the unit owners) not required.

GST treatment of compensation or settlement payments

21. The parties agreed that a compensation or settlement payment will not be a payment in the nature of a grant or subsidy. A payment for loss or damage is not consideration for a supply.

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[6] Unless declared to be a taxable grant or subsidy under s 5(6E)(a)(ii).

[7] *Tax Information Bulletin* Vol 3, No 1 (July 1991).

22. There is some crossover between the question of whether the Crown FAP Payments were gratuitous and whether the payments were compensation or settlement payments. Particularly relevant is the Crown has no duty of care to the Taxpayer in relation to weathertightness issues.

23. TCO considered the object of compensation is to financially restore the injured person to the position he or she would have occupied had the breach not occurred.[8] Where physical damage to a building has occurred as a result of the negligence of a builder, designer or local authority, the primary measure of damages is the cost of the remedial work or reinstatement.[9]

24. Case law indicates that when determining whether a payment is a compensation payment and not consideration for a supply the emphasis is on the legal arrangements actually entered into and carried out. For a payment to be consideration for a supply the courts focus on whether there is a nexus between the supply and the consideration. No such nexus is established where the payment is a compensation or settlement payment. Further, a payment to settle a dispute and avoid litigation is not a "payment in the nature of a grant and subsidy" for the purposes of s 5(6D).[10]

25. The position in the Commissioner's guidance on the GST treatment of court awards and out of court settlements[11] is that a payment may be made for the purpose of settling a dispute or to compensate for a loss even where the payer does not accept any liability for the loss. This requires determination of whether the payment is for the purpose of compensating for a loss.

26. When the court proceedings were settled, the Taxpayer and the Council agreed to participate in the FAP scheme under the WHRS Act. The provisions of the WHRS Act applied notably:

- s 125BA(2)(b) requires litigation to be discontinued (s 125BA makes no reference to the Crown).
- Section 125F gives the Crown protection from liability as a result of repairs undertaken through the FAP scheme.

[8] *Attorney-General v Geothermal Produce New Zealand Ltd* [1987] 2 NZLR 348 (CA).

[9] *Invercargill City Council v Hamlin* [1996] 1 NZLR 513.

[10] *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *New Zealand Refining Co Ltd v Commissioner Inland Revenue* (1995) 17 NZTC 12,307 (HC).

[11] Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

- Section 125G provides that claimants who enter into the FAP scheme may not name the contributing party (ie, in this case the Crown) or any additional contributing party as defendant in any civil proceedings.

27. TCO considered the WHRS Act and legislative history and concluded that:

- The purpose of s 125G of the WHRS Act (combined with the contribution criteria requiring a claimant who has commenced civil proceedings against the Council to discontinue those civil proceedings entirely) was to divert funds from taxpayers and the Council away from litigation towards the repair of the property.
- The reason for the inclusion of the Crown (as a contributing party) in the immunity provided by s 125G was out of an abundance of caution and to ensure that the Crown preserve its position of not incurring liability for leaky homes which the courts have found does not extend to the Crown.

28. That the Crown had no liability for leaky homes was the understanding of the Honourable Maurice Williamson (Minister for Building and Construction) when the FAP Bill was being enacted in 2011. At the first, second, and third readings of the Bill the Minister emphasised that the Crown did not need to make any such payment to homeowners and referenced the failed court attempts to hold the Crown liable for leaky homes damages. This view is consistent with the case law.

29. The Court of Appeal has held that the Building Industry Authority (**BIA**) (replaced in November 2004 by the Department of Building and Housing which became part of MBIE in July 2012) had no duty of care to property owners of homes with monolithic cladding systems to exercise reasonable care in connection with its statutory responsibilities.[12] The Supreme Court followed this reasoning in confirming that the BIA was not under a duty of care to property owners.[13]

30. The courts have taken a different view when considering the liability of territorial authorities/councils to property owners.[14] In summary, the courts' approach effectively means that MBIE owes no duty of care to property owners facing weathertightness issues as there is insufficient causality between the MBIE and homeowners. However, local authorities can owe a duty of care to property owners.

31. TCO concluded that the Crown FAP Payments were not compensation or settlement payments and neither is it appropriate to treat the Crown FAP Payments as part of

[12] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95.

[13] *North Shore City Council v Attorney-General* [2012] 3 NZLR 341.

[14] *North Shore City Council v Body Corporate 188529 (Sunset Terraces & Ors; North Shore City Council v Body Corporate 189855 (Byron Avenue) & Ors* [2011] 2 NZLR 289.

one overall FAP payment. In analysing the nature of a supply, the courts look at the underlying contract and what the supplier provided to the recipient.

32. The availability of the Crown FAP Payments and the Crown's immunity from civil proceedings arose under the WHRS Act. The relationship between the Crown FAP Payments and the settlement of the litigation arises from the Taxpayer's decision to repair the property through the FAP scheme. The Taxpayer was in legal proceedings involving the Council. The Taxpayer decided to repair the property under the FAP scheme instead of pursuing its legal claim against the Council (and others). As the focus is on the nature of the payment from the payer, not its character in the hands of the payee, whether the Taxpayer would have settled the litigation in the absence of the Crown FAP Payments is not relevant.

33. There was a discrepancy between the Crown FAP Payments and the Council FAP Payments despite the obligation of each party to pay 25% of approved costs under the FAP agreement. To the extent that the Crown has funded any part of the Council's payment obligations under the FAP Agreement, the amount would be considered to be a settlement or compensation payment. This is because the nature of the payment must be determined by the legal arrangements actually entered into and the rights and duties created. The parties agree the Council payment obligations are settlement or compensation payments and this would not be altered by the Crown partially funding the Council's payment obligations (if that is the reason for the disparity).

Consistency with Inland Revenue publications

34. The conclusion in this matter was considered to be consistent with the Commissioner's Statement on the GST treatment of MBIE leaky home payments.[15] That statement sets out the Commissioner's position that a payment under the FAP scheme is not a payment in respect of any actual supply of goods and services made by the body corporate in return for that payment. The Commissioner considers that the payments are in the nature of a grant or subsidy from the Crown under s 5(6D) and are therefore deemed to be in response to a supply from the body corporate. As a result, these payments are subject to GST.

35. A GST registered body corporate which receives such payments is therefore obliged to include the GST component in its GST return and to pay for any net GST output

[15] Commissioner's Statement CS 20/05, "GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package", *Tax Information Bulletin* Vol 32, No 10 (November 2020) at pages 2-4.

tax. A body corporate which is not registered (and not liable to be registered) for GST is not obliged to account for GST.

36. TCO also considered the Commissioner's published guidance on Treaty of Waitangi settlements.[16] Treaty settlements are not subject to GST because the settlement payments are not "consideration" for the supply of any goods or services made by the relevant Māori claimant group to the Crown. The Commissioner considers a Treaty settlement payment made by the Crown to provide redress for historical wrongs that were breaches of the Treaty of Waitangi is not gratuitous or a gift as it was "occasioned by a moral, and possibly legal, obligation [on the Crown] to correct the wrong done".

37. This obligation to compensate for breaches of New Zealand's founding document can be contrasted to the weathertightness issue where the Crown had no duty of care to the Taxpayer and no moral obligation to compensate the Taxpayer for the loss suffered from owning a leaky building.

[16] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)).