

Commissioner's Statement CS 20/01

GST liability for insurance and settlement payments to third party claimants – Section 5(13) of the Goods and Services Tax Act 1985

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter. A Commissioner's Statement is not a consultative document.

All legislative references are to the Good and Services Tax Act 1985 (the Act).

Summary

This Statement confirms the Commissioner's long-standing position on the GST liability of a GST registered third party claimant when they receive a payment for damages or loss incurred, including by way of settlement agreement, under a contract of insurance. The Commissioner's position is, and has been for many years, that when an insurer of an insured person pays an amount to a GST-registered third party claimant, in relation to a claim that the third party claimant has against the insured person, and the other requirements of section 5(13) of the Act are met, then the third party claimant must return GST on the receipt of that payment.

Background

It was recently identified that there has been confusion by some taxpayers as to whether or not a third party claimant has a GST liability under section 5(13) of the Act when an insured person's insurer pays an amount directly to a third party claimant in settlement of the insured person's liability to the third party claimant. Some taxpayers considered that the wording in section 5(13) meant that if an insurer made a payment to a GST registered third party claimant rather than to the GST registered insured person, the insurer was entitled to an input tax credit under section 20(3)(d), but the third party claimant did not incur a corresponding output tax liability. The Commissioner considers this latter assertion to be incorrect.

Explanation

Section 5(13) of the Act provides:

For the purposes of this Act, except for subsection (13B) and section 20(3), if a registered person receives a payment under a contract of insurance, whether or not the person is a party to the contract, the payment is, to the extent that it relates to a loss incurred in the course or furtherance of the

registered person's taxable activity, deemed to be consideration received for a supply of services performed by the registered person –

- (a) On the day the registered person receives the payment; and
- (b) In the course or furtherance of the registered person's taxable activity;

provided that this subsection shall not apply in respect of any payment received pursuant to a contract of insurance where –

- (a) The supply of that contract of insurance is not a supply charged with tax pursuant to section 8(1); or
- (b) That payment is in respect of an entitlement for any loss of earnings (being earnings within the meaning of the Accident Compensation Act 1982 or the Accident Rehabilitation and Compensation Insurance Act 2001); or
- (c) The supply of the contract of insurance is a supply that is chargeable with tax only because sections 5B and 8(4B) apply to it; or
- (d) The supply of the contract of insurance is a supply of remote services that is zero-rated under section 11A(1)(x).

When interpreting section 5(13), the Commissioner considers that the word “receives” as used in section 5(13), is intended to have a more constrained meaning, restricted to “actual” receipt of a payment (by the GST registered third party claimant) under a contract of insurance rather than any “constructive receipt” by the insured person.

It is considered that “receives” also has the meaning of “being paid”. Therefore, a third party claimant of a damages payment funded by the liability insurer of the insured person is “being paid” when they obtain a cheque, cash or have their bank account credited with that sum. Assuming that the relevant amount is being paid under a contract of insurance, then the third party clearly “receives” the payment within the meaning of section 5(13).

The word “under” as provided for in section 5(13) requires a broad interpretation. This is reinforced by the words that follow that – “whether or not the person is a party to the contract [of insurance]”. These words confirm that a person receiving a payment under a contract of insurance might not be a party to that contract. It is consistent with this to take the view that the focus is on whether the payer of the payment is doing so under a contract of insurance rather than whether the recipient receives the payment under that contract or under another agreement (such as a settlement agreement).

Amounts payable by an insurance company in an arrangement, are still amounts payable under the original insurance contract. It is just the quantification of the amount due under that contract that is fixed by the settlement agreement between the insured party and the third party claimant. The quantification of the sum due by the settlement agreement does not remove the liability of the insurance company under the insurance contract.

The Commissioner considers that this supports the view that “under” relates to a payment consequential on a claim under an insurance contract, even if quantification of

the amount to be paid is determined by a separate settlement agreement. The existence of a settlement agreement is not sufficient to break the connection between the payment to the third party claimant and the contract of insurance.

The Commissioner's position is that when an insurer of an insured person pays an amount to a GST-registered third party claimant, in relation to a claim that the third party claimant has against the insured person, and the other requirements of section 5(13) of the Act are met, then the third party claimant must return GST on the receipt of that payment.

Example:

While driving between plumbing jobs, Joe Bloggs accidentally drove over Farmer Fred's fence causing significant damage. In settlement of Joe's liability to Fred for the loss incurred, Joe's insurer, AGHY Insurance Ltd, pays Fred \$5,000 in settlement of Fred's claim under the contract of insurance. AGHY Insurance Ltd is entitled to a GST input tax credit. Fred, as a GST registered farmer, must return GST on the payment received from AGHY Insurance Ltd.

Application

This Statement confirms the Commissioner's long-standing position (which has been applied for many years) on the application of section 5(13) of the Act. As there has been **no** change in the Commissioner's position on this issue, the Commissioner will continue to apply this position to all cases, whether past, present or future.

If you have any concerns about your compliance with the tax obligations outlined in this Statement, you should discuss this matter with a tax professional or contact Inland Revenue to make a voluntary disclosure.

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Date of issue: 03 February 2020