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: 17 November 2021

Issue date | Te Rā Tuku: 30 March 2022

TDS 22/05

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 or CIR
WHRS Act	Weathertight Homes Resolution Services Act 2006
FAP	Financial Assistance Package scheme under the WHRS Act
TCO	Tax Counsel Office, Inland Revenue
MBIE or the Ministry	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 a large apartment block. The apartment block suffered weathertightness issues that required extensive remedial work.
2. In 2008 the Taxpayer lodged a claim under the Weathertight Homes Resolution Services Act 2006 (**WHRS Act**). In 2015 a settlement was negotiated with the Council and two other companies. A settlement agreement was entered into which was subject to the Taxpayer entering the Financial Assistance Package (**FAP**) scheme under the WHRS Act. The Crown was not a party to the settlement agreement.
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 states there is no admission of liability by the Ministry and/or the Council. A clause in the agreement recorded that:

- the Ministry and the Council each agreed to pay 25% of the remedial costs initially capped at a total of $10 million (including GST); and
- the Ministry agreed that it was making the payment as part of the settlement of a dispute between the Taxpayer and other parties.

4. Subsequently, MBIE advised the Taxpayer that costs would not be capped at $10 million and this particular clause was deleted in a 2019 amendment to the FAP Agreement.
5. Since July 2017 there has been a series of Crown FAP payments. The Taxpayer included all these payments in monthly GST returns and paid GST output tax on them.

Issues | Ngā take

6. The issue considered in this dispute was:
   - whether the Crown FAP Payments received by the Taxpayer during the periods ended 30 September 2020 and 31 December 2020 were a "payment in the nature of a grant or subsidy" under s 5(6D) and consequently subject to GST.
7. The GST treatment of the Council's FAP contribution to the Taxpayer was not in issue.

Decisions | Ngā whakatau

8. TCO decided that:
   - the Crown FAP Payments to the Taxpayer are gratuitous payments to encourage or promote the repair of leaky buildings. 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 (GST Act). The Crown FAP payments are therefore deemed to be consideration for a supply under s 5(6D) of the GST Act.

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)

9. 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.

10. 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.

11. 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 arose under the FAP Agreement and were, in form and substance, payments to settle any legal liability of the Crown (and possibly in part the legal liabilities 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.

12. 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.

13. 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.

14. The parties agreed that the latter three requirements were met in relation to the Crown FAP Payments. The issue to be considered was the first bullet – whether the payment was in the nature of a grant or subsidy.

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

15. The GST Act provides an inclusive and non-exhaustive definition of a "payment in the nature of a grant or subsidy" in s 5(6E). Some specific payments are expressly included and others expressly excluded from the definition. None of the specific inclusions and exclusions were considered relevant in this case.

16. The common thread in the definitions 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]

17. 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.

18. 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]

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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 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).

[4] *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.

19. 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.

20. 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 the Crown was under no obligation to make the payments.[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 repair of leaky homes is beneficial to the public interest, or enables the Taxpayer to provide services to members of the public at a concessionary price, this criterion is 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.

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.

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.

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

23. TCO considered the object of compensation is to financially restore the injured person to the position which he or she would have occupied had the breach not occurred.[6] 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.[7]

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).[8]

25. The position in the Commissioner's guidance on the GST treatment of court awards and out of court settlements[9] 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. It was a pre-condition of the settlement of proposed litigation between the Taxpayer and the Council and two other companies (not including the Crown) that the Taxpayer enter into the Government's FAP scheme under the WHRS Act.

27. Upon entering into the FAP scheme the Taxpayer was required under s 125BA(2)(b) of the WHRS Act to discontinue the litigation it had commenced against the Council. Section 125BA makes no reference to the Crown.

28. Section 125G of the WHRS Act 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. 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

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

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

[8] *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *New Zealand Refining Co Ltd v CIR* (1995) 17 NZTC 12,307 (HC).

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

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.

29. 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.

30. 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.[10] The Supreme Court followed this reasoning in confirming that the BIA was not under a duty of care to property owners.[11]

31. The courts have taken a different view when considering the liability of territorial authorities/councils to property owners.[12] 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.

32. TCO concluded that the payments were not compensation or settlement payments. This is because whether a payment is a grant or subsidy is determined from the point of view of the payer, and the Crown FAP Payments were not made to settle the dispute between the Taxpayer and the Council or any dispute between the Taxpayer and the Crown. While s 125G of the WHRSA provides immunity, this was included out of an abundance of caution and does not indicate that the Crown entered into the FAP Agreement to protect itself from liability.

33. In response to particular arguments (including that the Crown FAP Payments and Council FAP payments should be treated as one overall FAP payment) TCO considered:

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

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

[12] *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.

- Upon entering into the FAP scheme the Taxpayer was obligated under s 125BA(2)(b) of the WHRS Act to discontinue the litigation it had commenced against the Council but s 125BA makes no reference to the Crown.
- The Crown was not a party to the Settlement Agreement which settled the Taxpayer's claim for damages from the Council (and two other companies).
- Whether a payment made is in the nature of a grant or subsidy is determined from the payer's point of view. It follows that the fact that the Taxpayer may not have reached a settlement in its dispute with the Council and two other companies in the absence of the Crown agreeing to pay 25% of the Approved Costs is not relevant in determining the nature of the Crown FAP Payments from the Crown's point of view.
- The FAP scheme is not limited to homeowners who settled disputes with a territorial authority or council. The Crown may still contribute to the cost of repairs even if a council does not owe a duty of care to the claimant provided the claimant meets the other contribution criteria. For this reason it is not considered that the level of the Crown FAP Payments was to induce the Council and Taxpayer to settle their dispute.
- The clause in the FAP Agreement recording MBIE's agreement that it was making payment as part of the settlement of the dispute was deleted by the 2019 amendment.
- The 2019 amendment supports the view that the Crown FAP payment was not to secure settlement of the Taxpayer's dispute. The 2019 amendment effectively meant the Crown contribution to the remedial work would not be capped at $10 million but would instead be the actual costs and expenses the Taxpayer incurred. The Crown FAP Payments were increased at a point when the Taxpayer had already settled its dispute with the Council and the Taxpayer's legal rights to name the Crown in any future civil proceedings relating to the property was restricted. This supports the view that the nature of the Crown FAP Payments was a gratuitous payment to assist with the cost of repairing the Taxpayer's property to remedy problems arising from it not being weathertight.
- The purpose of s 125G (combined with the requirement that a claimant who has commenced civil proceedings against the Council discontinue those proceedings) was to divert funds from the Taxpayer and the Council away from litigation towards the repair of the property. The inclusion of the Crown (as a contributing party) in the immunity provided by s 125G was out of an abundance of caution, namely, 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.

- MBIE's annual report did not in TCO's view describe the Crown contributions under the FAP scheme as a payment to settle and manage litigation risk.

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.[13] That statement sets out the Commissioner's position that payments under the FAP scheme are 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 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.[14] 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.

[13] 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.

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