

GSTD 2011/1 - Goods and services tax: Goods and services tax: is an ex gratia payment by an insurer in response to a claim under an insurance policy a payment made 'in settlement of a claim'?

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! This document has changed over time. This is a consolidated version of the ruling which was published on *9 May 2018*



Goods and Services Tax Determination

Goods and services tax: is an *ex gratia* payment by an insurer in response to a claim under an insurance policy a payment made ‘in settlement of a claim’?

❶ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

[Note: This is a consolidated version of this document. Refer to the Legal Database (<http://www.ato.gov.au/law>) to check its currency and to view the details of all changes.]

Ruling

1. Yes, an *ex gratia* payment by an insurer in response to a claim made under an insurance policy is a payment made in settlement of a claim for the purposes of section 78-10 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).¹
2. The payment may be made to the insured or to a third party, where the payment is made in settlement of the claim.

¹ All legislative references in this Determination are to the GST Act unless otherwise indicated.

Example

3. *The Rundle Insurance Company (RIC) made a taxable supply of an insurance policy to Larry and Edith. The supply of the insurance policy was solely a taxable supply and there was no entitlement to an input tax credit for the premium paid. The insurance policy provides cover over Larry and Edith's residential premise which includes cover for flooding caused by a storm. Larry and Edith's residential premises were affected by flooding for which Larry and Edith made a claim on their insurance policy. RIC were in dispute with Larry and Edith about whether the flooding fell within the terms of the policy. RIC made an ex gratia payment to Larry and Edith on agreement from Larry and Edith that they would take no further action against RIC in relation to the flooding event. The ex gratia payment constitutes a payment in settlement of a claim under an insurance policy for the purposes of section 78-10.*

Date of effect

4. This Determination applies both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

4A. Changes made to this Determination by Addenda that issued on 9 May 2018 have been incorporated into this version of the Determination.

Commissioner of Taxation

29 June 2011

Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

5. In response to a claim by a policy holder, an insurer may choose to make a payment of an amount which is not strictly due under the terms of the policy. The payment will be made to the insured or to a third party. The insured will be asked to sign a document (including electronically) releasing the insurer from all liability under the policy, or otherwise be recorded as doing so, such as through recorded telephone conversations. The payment is made for economic reasons such as for goodwill, but without an admission of liability.

6. These payments are commonly known as *ex gratia* payments.

7. Subsection 78-10(1) stipulates that an insurer has a decreasing adjustment if, in settlement of a claim under an insurance policy, the insurer makes one or more of the following:

- (a) a payment of money;
- (b) a payment of digital currency;
- (c) a supply.

8. Subsection 78-10(2) sets out the conditions for the decreasing adjustment.

9. It must be determined if an *ex gratia* payment constitutes a payment that is made in settlement of a claim for the purposes of subsection 78-10(1).

A claim under an insurance policy

10. The term 'claim' is not defined in the GST Act and therefore takes its ordinary meaning. The Legal Dictionary² defines 'claim' as

The assertion of a right or demand to a right to property or to a remedy, a cause of action, and the grounds in pleadings upon which relief is claimed...

11. The meaning of the term 'insurance policy' in section 195-1 is:

A policy of insurance (or of reinsurance) against loss, damage, injury or risk of any kind, whether under a contract or a law. However, it does not include such a policy to the extent that it does not relate to insurance (or reinsurance) against loss, damage, injury or risk of any kind.

12. Therefore the phrase 'a claim under an insurance policy' means exercising a right, under a contract or statute, to remedy against loss, damage, injury or risk. The phrase also means asserting, making a demand to, and a right, under a contract or statute, to such remedy.

13. Hence, a claim may be made under an insurance policy irrespective of whether or not there is a right to remedy under the terms of the policy.

² *Butterworths Concise Australian Legal Dictionary*, 2004, 3rd edn, LexisNexis Butterworths, Australia.

In settlement of a claim

14. The term 'settlement' is not defined in the GST Act and therefore takes its ordinary meaning. The Legal Dictionary defines 'settlement' as:

A disposition of property; the compromise or resolution of a claim or dispute

15. In the context of insurance, the term 'settled' has been held to mean 'adjustment of the loss', or accepting liability for the loss.³ This might seem to preclude an *ex gratia* payment, for which no liability is accepted.

16. However, in the context of insurance the Legal Dictionary defines an *ex gratia* payment as:

Insurance A payment made by way of settlement of a claim without admission of liability: *Edwards v. Skyways Ltd* [1964] 1 All ER 494 at 500...

17. The *Encyclopaedic Australian Legal Dictionary*⁴ defines *ex gratia* payment in the insurance context in a similar fashion:

Insurance

A payment made by way of settlement of a claim without admission of liability: *Edwards v. Skyways Ltd* [1964] 1 All ER 494. In insurance law, an insurer may offer the insured an *ex gratia* payment to settle a claim when there is a dispute between the parties as to the right to claim under the policy. The insured will generally be asked to sign a document releasing the insurer from all liability under the policy.

18. The issue dealt with in *Edwards v. Skyways* was whether the commitment to make an *ex gratia* payment was enforceable. On this matter Megaw J states:

The words 'ex gratia' or 'without admission of liability' are used simply to indicate-it may be as a matter of *amour propre*, or it may be to avoid a precedent in subsequent cases- that the party agreeing to pay does not admit any pre-existing liability on his part; but he is certainly not seeking to preclude the legal enforceability **of the settlement itself** by describing the contemplated payment as 'ex gratia'. [Emphasis added.]

19. *Edwards v. Skyways* is often cited as authority in legal references for what are *ex gratia* payments, and for their enforceability.

20. It follows from this that an *ex gratia* payment, in the insurance context, may be made 'in settlement of a claim' where the insurer is released from all liability in relation to the claim.

A payment

21. Subsection 78-10(1) stipulates that an insurer has a decreasing adjustment if, in settlement of a claim under an insurance policy, the insurer makes one or more of the following:

- (a) a payment of money;
- (b) a payment of digital currency;
- (c) a supply.

³ *Street v. Royal Exchange Assurance* (1914) 111 LT 235 at 235,237, CA per Lord Reading CJ.

⁴ Online: LexisNexis.

22. At paragraphs 7 and 8 of Goods and Services Tax Ruling GSTR 2006/10 Goods and services tax: insurance settlements and entitlement to input tax credits, the Commissioner states:

7. Under a general insurance policy, there are a number of alternatives available to an insurer in settling a claim. For example, if insured goods are damaged, lost or stolen, an insurer may:

- reimburse the insured or a third party with a cash payment for replacing or repairing the goods;
- reimburse the insured or a third party by way of payment of digital currency for replacing or repairing the goods;
- provide the insured or a third party with a voucher to replace the goods;
- arrange to pay the supplier directly for goods being supplied to the insured or a third party;
- organise for a supplier to repair the goods or to supply replacement goods to the insured or a third party; or
- acquire replacement goods and supply them to the insured or a third party.

8. For the purposes of this Ruling, when we use the term 'third party', we are referring to an entity that the insured has a liability to. For example, the insured has a liability to an entity because of damage caused by the insured to that entity. Consequently, the insurer may make a payment or a supply to that entity in settlement of the insured's claim under the policy.

23. Therefore, as a claim under an insurance policy can be settled by making payment of money, payment of digital currency, making a supply, or a combination of those, it follows that a claim can be settled *ex gratia* in all of those ways as well. Hence, where we have referred to making an *ex gratia* payment in settlement of a claim in this Determination, it includes making a supply or making both a payment and a supply.

24. The payment may be made to the insured or to a third party, where the payment is made in settlement of the claim.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10, GSTR 2006/10

Legislative references:

- ANTS(GSTA) 1999 78-10
- ANTS(GSTA) 1999 78-10(1)
- ANTS(GSTA) 1999 78-10(2)
- ANTS(GSTA) 1999
- TAA 1953
- Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill (No. 2 1999)

Case references:

- *Edwards v. Skyways Ltd* [1964] 1 All ER 494
- *Street v. Royal Exchange Assurance* (1914) 111 LT 235

Other references:

- *The Australian Oxford Dictionary*, 2004, rev. 2nd edn, Oxford University Press, Melbourne
- *Mozley & Whiteley's Law Dictionary*; *Black's Law Dictionary*; *Butterworth's Australian Legal Dictionary*
- *Encyclopaedic Australian Legal Dictionary* Online LexisNexis

ATO references

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Decreasing adjustments
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Settlements and claims