

Please note that the following Policy Statement, although correct at the time of issue, may not have been updated to reflect any subsequent legislative changes.

GST/HST POLICY STATEMENT

P-218 Tax Status of Damage Payments Not Within Section 182 of the Excise
Tax Act

DATE OF ISSUE

May 25, 1998

SUBJECT

Tax Status of Damage Payments Not Within Section 182 of the Excise Tax Act
(ETA)

LEGISLATIVE REFERENCE(S)

Subsection 123(1) - definitions of “consideration”, “supply”, “taxable supply”,
“property”, “personal property”, “money” and “service”
Subsections 165(1) and (2) - imposition of GST and HST
Subsection 182(1) - forfeiture, extinguished debt, etc.

NATIONAL CODING SYSTEM FILE NUMBER(S)

11735-1

EFFECTIVE DATE

January 1, 1991 for GST
April 01, 1997 for HST

TEXT

Issue and Decision:

This policy statement explains the application of Part IX of the *Excise Tax Act* (the Act) to payments of money where one person causes another person to suffer damages (e.g., property damage, loss of income, inconvenience, etc.) and pays an amount of money to that person as compensation for the damages suffered or allegedly suffered.

There are many situations in both commercial and non-commercial activities where one person makes a payment to another person as compensation for damages. Some of these situations are covered by section 182 of the Act. However, there are many situations where one or more of the conditions in section 182 of the Act are not met. These situations could include:

- no prior agreement for a taxable supply existed between the parties;
- the payment is being made by the supplier of the original supply;

- the original supply was not made by a registrant; or
- the payment is actually additional consideration for the original supply.

This policy statement applies to those payments that are outside section 182 of the Act. The sample rulings in this policy statement are all examples of situations where section 182 of the Act does not apply.

It is the Department's position that a damage payment, to the extent that it is not a payment for a supply of property or a service, is not consideration for a supply even if the payee agrees to release the payor from further liability. For purposes of this policy statement, a damage payment is the payment of an amount of money from one person to another as compensation or indemnification for damages that the first person has caused the second person to suffer, or allegedly suffer.

Damages may be compensatory or punitive in nature, according to whether they are awarded as the measure of actual loss suffered or a punishment for outrageous conduct and to deter future transgressions. Nominal damages are awarded for the vindication of a right where no real loss or injury can be proved. Generally, punitive or exemplary damages are awarded only if compensatory or actual damages have been sustained.

Damages may arise in tort and similar causes of action at law, but will also include damages arising out of contractual relationships and those based on quasi-contract, statute or otherwise. The payments may be made pursuant to a court award or an out-of-court settlement. In an out-of-court settlement, the party making the payments may not admit liability with respect to the underlying cause of action.

There will be situations where a payment is made in the context of a claim for damages, but the payment can be linked directly to the provision of some property or service by the payee in return for the payment, and for which purpose the payment is being made. The payment is not made to compensate the payee, but rather to obtain the property or service being provided by the payee. Sample ruling number 5 is an example of this type of payment.

A distinction must also be drawn between those cases where a person compensates another by payment of money and those where the person contracts with a third party to repair the damage. If, for example, a person breaks someone else's window and contracts with a third party to repair the window, the third party is making a taxable supply of a service of repairing a window to the person. As the person who is liable for the payment under the agreement with the third party, the person is the recipient of the service. The third party, if a registrant, would collect tax from the person.

SAMPLE RULING NO. 1

Our understanding of the facts and transactions is as follows:

Statement of Facts

1. Aco, a registrant, contracted with Bco, a registrant, whereby Bco would design and install a new software program for implementation by a certain date.
2. As the deadline date approached, it became obvious that Bco would not be able to fulfill its obligations under the contract.
3. Aco incurred additional expenses as a result of the non-delivery of the new software program.
4. Pursuant to negotiations, Aco agreed to release Bco from the contract in exchange for a sum of money.

Ruling Requested

The payment by Bco to Aco is not subject to GST/HST.

Ruling Given

The payment by Bco to Aco is not subject to GST/HST.

Rationale

The payment is not consideration for a taxable supply. It is in essence compensatory and is not made in exchange for a supply of property or services by the other party. Additionally, the acceptance of the payment does not result in the payment being consideration for a supply, in that it represents compensation for additional expenses incurred and that would be incurred as a result of the non-delivery of the new software program. The payment is meant to restore, to some degree, Aco to the position it was in prior to the damage occurring.

SAMPLE RULING NO. 2

Our understanding of the facts and transactions is as follows:

Statement of Facts

1. Dr. X, a plastic surgeon, was sued by one of his patients, Mr. Y, for negligence.
2. The case proceeded to trial and at the conclusion of the trial, the court held that Mr. Y had suffered a significant amount of pain and humiliation as a result of Dr. X's negligence.

3. Accordingly, the court ordered the payment of an amount of money to Mr. Y as compensation.

Ruling Requested

The payment by Dr. X to Mr. Y is not subject to GST/HST.

Ruling Given

The payment by Dr. X to Mr. Y is not subject to GST/HST.

Rationale

The payment is not consideration for a taxable supply. It is in essence compensatory and is not made in exchange for a supply of property or services by the other party. Additionally, the acceptance of the payment does not result in the payment being consideration for a supply, in that it represents compensation for the pain and humiliation suffered. The extinguishment of Dr. X's liability upon payment is not the reason for the compensation.

SAMPLE RULING NO. 3

Our understanding of the facts and transactions is as follows:

Statement of Facts

1. Ms A lost control of her vehicle and smashed into the display window of a business establishment (B Ltd.), a registrant.
2. B Ltd. performed the necessary repairs and demanded compensation from Ms A in the amount of the cost incurred to repair the damaged window.
3. Ms A refused to reimburse B. Ltd.
4. B Ltd. commenced legal action against Ms A to obtain payment.
5. In an out-of-court settlement, Ms A made a payment to B Ltd. in the amount of the cost incurred to repair the damaged window, which B Ltd. accepted in full satisfaction of its claim against Ms A and released Ms A from any further liability.

Ruling Requested

The payment by Ms A to B Ltd. is not subject to GST/HST.

Ruling Given

The payment by Ms A to B Ltd. is not subject to GST/HST.

Rationale

The payment is not consideration for a taxable supply. It is in essence compensatory and is not made in exchange for a supply of property or services by the other party.

Additionally, the acceptance of the payment does not result in the payment being consideration for a supply, in that it represents compensation for the damage to B Ltd.'s display window. The payment is meant to restore, to some degree, B Ltd. to the position it was in prior to the damage occurring.

SAMPLE RULING NO. 4

Our understanding of the facts and transactions is as follows:

Statement of Facts

1. A freight carrier (Transco) badly damaged the goods that it was transporting for its customer (Shipco).
2. Under the terms of the original agreement for the transportation of the goods, Transco was required to reimburse Shipco for the full value of the goods and ownership of the goods then passed to Transco.
3. As part of the settlement, Shipco signed a release form releasing Transco from any further liability for the damaged goods.
4. Transco is a registrant and Shipco is a registrant making taxable supplies (not zero-rated).
5. Transco was able to salvage the goods and sell them for a portion of their original value.

Ruling Requested

The payment by Transco to Shipco is not subject to GST/HST.

Ruling Given

The payment by Transco to Shipco is not subject to GST/HST.

Rationale

The payment is not consideration for a taxable supply. It is in essence compensatory and is not made in exchange for a supply of property or services by the other party.

Additionally, the acceptance of the payment does not result in the payment being consideration for a supply, in that it represents compensation for the loss of Shipco's goods. The payment is meant to restore, to some degree, Shipco to the position it was in prior to the damage occurring. The change in ownership of the goods under the original agreement is not the reason for the compensation.

SAMPLE RULING NO. 5

Our understanding of the facts and transactions is as follows:

Statement of Facts

1. Aco, a registrant, was using a particular trading name and style of logo for some time (Info-Link).
2. Aco became aware that another company (Bco), a registrant, had applied to the appropriate authorities to register a similar trading name and logo, and that this could potentially be damaging to Aco's business.
3. Aco began legal proceedings against Bco.
4. As a result of an out-of-court settlement, Bco made a payment to Aco, in exchange for Aco's agreement to change its name to Zco and in the future, not to use the word "Info-Link" or anything similar.

Ruling Requested

The payment by Bco to Aco in respect of the change of name is not subject to GST/HST.

Ruling Given

The payment by Bco to Aco in respect of the change of name is subject to GST/HST.

Rationale

The payment is consideration for a taxable supply. In this case, Bco received something of value in return for the payment. The payment was made to obtain the performance of an action by Aco, that is, the change in name by Aco and Aco's agreement to discontinue the use of the name "Info-Link" in the future. These actions constitute a taxable supply of a service by Aco.

DECISION TREE

Issue: Tax Status of Compensatory Damage Payments

