

QUESTION WE'VE BEEN ASKED QB 14/14

GOODS AND SERVICES TAX – LATE RETURN CHARGES (INCLUDING LIBRARY FINES AND PARKING OVERSTAY CHARGES)

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Question We've Been Asked (QWBA) is about ss 2, 8 and 10.

During a review of the *Public Information Bulletin* and *Tax Information Bulletin* series published before 1996, the answer to Question 8 (in a series of GST questions and answers) in *Public Information Bulletin* No 148 (May 1986): 3 was identified as an item that should be updated. The review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013): 37.

This QWBA updates and replaces the part of the *Public Information Bulletin* item that concerns library fines and vehicle parking fines (also known as parking overstay charges). For ease of reference, this QWBA refers to these fines collectively as "**late return charges**". The analysis in this item also applies more broadly to all charges imposed for the late return of a borrowed item (ie, not just to library fines and vehicle parking fines).

Question

1. Is a late return charge subject to GST?

Answer

2. A late return charge will be subject to GST if it is consideration for a taxable supply. Whether the charge is consideration for a taxable supply will depend on whether a sufficient nexus or reciprocity exists between the charge and the supply. This will be determined from the legal arrangements entered into.
3. In most cases, a late return charge will be subject to GST. This is because the legal arrangements between the parties will characterise the charge as additional consideration for the supply of the borrowed item.
4. However, in some cases, the legal arrangements between the parties may characterise the late return charge as a payment of damages or a penalty for a breach of the legal arrangements. In these cases, the charge will not be subject to GST because it will not be consideration for a taxable supply.

Explanation

Background

5. *Public Information Bulletin* No 148 (May 1986): 3 contained a series of questions and answers on GST. Question 8 asked, "**Are vehicle parking fines and library fines etc. subject to GST?**". The answer was:

Yes – they are consideration for the provision of goods and services. However, Court fines are not subject to GST because they are not paid as consideration for the supply of goods and services. Rather they are penalties imposed by Statute as punishment for criminal activities.
6. Late return charges are charges imposed for the late return of a borrowed item such as a library book or a DVD. These charges are sometimes referred to as "**overdue fines**". Car-park operators impose similar charges on drivers who

overstay in a parking space. These charges all share similar features. For ease of reference, we refer to them collectively as "late return charges".

7. Late return charges are different from late payment charges. Late payment charges are amounts businesses charge for the late payment of an account. Under s 5(25) and (26), a late payment charge will be subject to GST if the underlying supply to which that payment relates is subject to GST.

GST treatment of late return charges

8. The Commissioner considers the law in this area to be well settled. The late return charge is either consideration for a supply or not. The Commissioner has set out the principles to be applied in "**GST Treatment of Court Awards and Out of Court Settlements**" *Tax Information Bulletin*, Vol 14, No 10 (October 2002): 21 and "**GST – Hire Firm Security Bonds**" *Tax Information Bulletin* Vol 26, No 7 (August 2014): 131. This QWBA simply applies these principles to different fact scenarios.

Taxable supply

9. Section 8(1) imposes GST on the supply of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person. GST is charged on the value of that supply. The value of a supply is the "consideration" paid for the supply (ss 2(1) "consideration" and 10).
10. Therefore, the first step is to identify a supply, if any, for which the late return charge could be consideration. The next step is to determine whether the late return charge is consideration for that supply (see *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093 (CA)).
11. When analysing transactions for GST purposes, the focus is on the legal rights and obligations created by the parties. The economic substance of the transaction is not relevant, and the nomenclature used is not decisive. The important question is whether a sufficient nexus or reciprocity exists between the supply of the goods or services and the consideration (see *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA), *Chatham Islands Enterprise Trust v CIR* [1999] 2 NZLR 388 (CA); *Gulf Harbour Developments Ltd* (2004) 21 NZTC 18,915 (CA); *Rotorua Regional Airport v CIR* (2010) 24 NZTC 23,979).

Characterisation of late return charges

12. To determine the correct GST treatment of a late return charge it is necessary to examine the legal arrangements entered into between the parties. The late return charge can be characterised in at least two ways: as consideration for a taxable supply or as a payment for a breach of contract.

Consideration for a taxable supply

13. In most cases, a charge imposed under a contract for the late return of a borrowed item will be characterised as consideration for the supply of the borrowed item. A sufficient nexus will exist between the supply of the borrowed item and the charge imposed for its late return.
14. This was the decision reached by the United Kingdom VAT Tribunal in *Leigh t/a Moor Lane Video* (1990) 5 BVC 757 and by the Tax Court of Canada in *Acme Video Inc v R* [1995] GSTC 49. In both cases, the issue was whether a late return charge imposed for the late return of video films was subject to value-added tax (VAT) or GST. In *Leigh*, the contract described the charge as "compensation not exceeding £2.50 for each day or part of a day after it was due". The fine was the same amount as the nightly hire rate. In *Acme*, the contract provided that "the hirer agrees to pay all additional rental or surcharges"

that may be due as a result [of the late return]". In both cases, the courts held that the late return charges were liable to VAT/GST as consideration for the supply of the borrowed item.

15. In some cases, the initial supply of the item will be for no consideration (a library book, for example). **In the Commissioner's opinion**, this will not affect the GST treatment of the late return charge.

Payment for a breach of contract

16. A charge imposed under a contract for breaching the terms of that contract will not be subject to GST. This is because the charge is imposed for the breach rather than as consideration for a supply. In this situation, the charge will not have a sufficient nexus or reciprocity with the supply (see *NZ Refining Co Ltd*, and *Chatham Islands Enterprise Trust*).
17. Depending on the terms of the contract, a charge for a breach of contract could be described as liquidated damages (an amount agreed to be paid for a breach of contract) or as a penalty (a punishment for a breach of contract). While the distinction between liquidated damages and penalties is important for contract law purposes, it is not significant for GST purposes; neither payment will be subject to GST.

Examples

18. The following examples help to explain how the law applies to particular situations.
19. The GST consequences of each example are a result of the particular facts. Any additions or variations to the facts may give rise to different GST consequences.

Example 1 – consideration for a supply

20. Oscar joins the Central Library. He signs a membership agreement and agrees to be bound by the terms and conditions outlined in the agreement. Oscar takes out a book on quantum physics. The library terms and conditions state that this book can be borrowed for 28 days without charge. After that time, fines will be charged for each day that the book remains overdue. **Regarding "overdue fines"**, the membership agreement notes:

Membership agreement – terms and conditions

All Central Library members agree to be bound by the library fees and charges. Fines accrue each day the book/item is overdue. Details of overdue fines are posted on the Central Library website and must be paid when the item is returned.

21. The Central Library website contains a list of overdue fines. An overdue fine of 60c per day, per item is imposed for all books once the 28-day borrowing period has expired. Oscar returns the book 10 days late and has to pay a \$6 fine. The fine is subject to GST because it is consideration for the supply of the book. The fact that it is called a fine does not affect its character as consideration for the supply. It is also not determinative that the initial supply of the library book was a supply for no consideration.

Example 2 – further consideration for a supply

22. Louis joins a DVD library. He signs a membership agreement and agrees to be bound by the terms and conditions of hire. Regarding the late return of DVDs, the agreement states:

The member agrees:

- a. To return the film by the agreed date. If the film is not returned by the agreed date, the member shall be required to pay an additional hire charge of \$7 per day until the film is returned, capped at \$35.
23. Louis hires a new release DVD. The hire period for new releases is one night. Louis returns the DVD three days late. The DVD library makes Louis pay the additional hire charge of \$21. The additional hire charge is subject to GST because it is consideration for the supply of the DVD.

Example 3 – further consideration for a supply

24. **Tim parks his car in Cinema car park. Cinema car park is a “pay and display” car park.** Tim purchases a ticket from one of the machines, guessing that he will need to pay for four hours. The hourly rate is \$3, so Tim pays \$12 for four hours. Tim is attending a screening of a new movie and hopes to catch up with friends afterwards. The terms and conditions of parking are printed on various signs around the car park. They state:

Cinema car park is, by this sign, offering space for public parking. You accept this offer by parking here. All requirements of notice and acceptance are hereby waived by Cinema car park. If you park, but do not display a valid unexpired ticket, you will be charged a further \$50 per day for parking. If you park here Cinema car park considers you to have accepted its offer of a parking space. Do not park here if you do not agree to these terms.

25. Tim is two hours late returning to his car. By this time, Cinema car park has issued him with a \$50 charge for failing to display a valid unexpired ticket. The charge is subject to GST. The terms of the agreement are clear; the onus is on Tim to purchase a ticket for the time actually needed. By failing to purchase a ticket for the time actually needed, he is contractually bound to pay the additional charge of \$50 for parking his car. The payment is further consideration for the taxable supply of the car park space.

Example 4 – payment for a breach of contract

26. Alisha parks her car in the Centre car park. The car park is operated as a **“pay and display” car park**. Alisha purchases a ticket from one of the machines. She estimates it will take her two hours to complete her shopping. The hourly rate is \$5, so Alisha pays \$10 for two hours. The terms and conditions of parking are printed on the back of the ticket. They note:

If your vehicle does not clearly display a valid unexpired prepaid ticket then you will be parking without our consent and in breach of the terms and conditions of this agreement. As a consequence of this breach we may issue you with a parking violation notice requiring you to pay a fine of \$100. You will have 28 days to pay this fine. We may also have your car towed at your own risk and expense.

27. Unfortunately for Alisha she underestimates the time it takes to complete her shopping. She returns to the car park half an hour late and discovers Centre has issued her with a parking violation notice requiring her to pay a fine of \$100.
28. The charge is not subject to GST because it is a payment for breaching the contract and not consideration for the taxable supply of the parking space. No nexus or reciprocity exists between the charge and the supply of the parking space. This conclusion is supported by the fact the charge imposed bears no relationship to the actual amount that would have been payable for the extra half-hour hire of the parking space. The charge is the same whether Alisha is half an hour late, 3 hours late or 10 hours late. The charge has the characteristics of a penalty.

References

Related rulings/statements

"GST – Hire Firm Security Bonds" *Tax Information Bulletin*, Vol 26, No 7 (August 2014): 131

"GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin*, Vol 14, No 10 (October 2002): 21

Subject references

Consideration

Fine

GST

Late return charge

Library

Parking overstay charge

Penalty

Taxable supply

Legislative references

Goods and Services Tax Act 1985, ss 2, 8 and 10

Case references

Acme Video Inc v R [1995] GSTC 49 (TCC)

Chatham Islands Enterprise Trust v CIR [1999] 2 NZLR 388 (CA)

CIR v Databank Systems Ltd (1989) 11 NZTC 6,093 (CA)

CIR v NZ Refining Co Ltd (1997) 18 NZTC 13,187 (CA)

Gulf Harbour Developments Ltd (2004) 21 NZTC 18,915 (CA)

Leigh t/a Moor Lane Video (1990) 5 BVC 757 (UK VAT Tribunal)

Rotorua Regional Airport v CIR (2010) 24 NZTC 23,979