Regulatory Impact Statement

GST and late payment fees

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It addresses an issue with the GST treatment of late payment fees by taxpayers and a potential significant fiscal risk if GST is not payable on the fees.

Late payment fees are fixed fees charged by businesses to their customers on late payment of accounts. The fees are different from penalty and default interest payments which are specifically GST-exempt in the same way as other financial transactions.

Inconsistency between interpretation and practice has created a lack of clarity around the application of the GST rules to late payment fees. The current interpretation of the law raises boundary issues that would result in different GST treatments for comparable fees, such as prompt payment discounts, depending on how the fees are structured. There should not be a difference in GST treatments between two similar types of charges when GST is intended to be imposed on the consideration for any transaction. The current interpretation creates a significant fiscal risk to the GST base. It means that taxpayers, most of whom have charged GST on late fees to their customers, may be entitled to a refund of the output tax that they have returned to Inland Revenue.

We recommend that a legislative amendment be made to clarify that late payment fees are subject to GST and this be made retrospective. However, we recommend a savings provision that would preserve the position that a small minority of taxpayers may have taken in relation to this matter before the effective date of the proposed legislative amendment.

A general limitation of our analysis was the time constraint in developing the options. A prompt change was considered necessary as maintaining the status quo raises a potentially significant fiscal risk. We consulted with the Treasury, which agrees with our analysis. Full consultation has not been undertaken with the public so as not to signal a potential base maintenance change that could result in a behavioural change by taxpayers. We do, however, intend to inform a small number of taxpayers, who may be affected by the amendment, of the proposed legislative change closer to the date of bill introduction.

The proposed amendment does not impair private property rights, reduce market competition, provide disincentives to innovate and invest or override common law principles. As noted, a retrospective amendment in this area would remove the ability of taxpayers to seek GST refunds. However, the savings provision would maintain the existing treatment for all affected taxpayers.

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20 July 2011

STATUS QUO AND PROBLEM DEFINITION

1. This statement considers options to address a recent issue relating to GST and late payment fees. Late payment fees are fixed fees charged by businesses to their customers in respect of the late payment of accounts – for example, a telephone company may charge their customers a set fee for the cost of administration if they do not pay their monthly telephone bill on time. These fees are common across a range of sectors and charging GST on these fees is a common practice among many businesses. The fees are different from penalty or default interest payments which are specifically GST-exempt under the Goods and Services Tax Act 1985 ("the GST Act") in the same way as financial transactions.

2. Under the GST Act, GST is only charged on a taxable supply. The term "supply" being very broadly defined in keeping with the policy of GST having the broadest base that is practically possible. However, under the current interpretation of the law, no GST should be imposed late payment types of fees as there is a lack of connection between the fee charged and the underlying supply of goods and services, even though they may represent the cost of administering the late payment. This is inconsistent with both the policy of a broad-based tax and with Inland Revenue's public statement to date which has been that while penalty interest is clearly not subject to GST, late payment fees are subject to GST.[1]

3. The current interpretation of the law raises boundary issues that would result in different GST treatments for comparable fees depending on how the fees are structured. There should not be a difference in GST treatments between two types of charges when GST is intended to be imposed on the consideration for any transaction. In this respect, late payment fees should be treated in the same manner as prompt payment discounts.

4. Inconsistency between interpretation and practice has created a lack of clarity around the application of the GST rules to late payment fees. If this is maintained, there will be an ongoing fiscal cost of around $3.3 million per year. This would be the result of taxpayers who currently charge GST on late fees no longer charging it. Moreover, the same group of taxpayers may be entitled to a refund of the output tax that they have already returned to Inland Revenue. This is estimated to amount to a one-off revenue loss of approximately $13.8 million.

OBJECTIVES

5. The main objective is to clarify the current law around GST and late payment fees. A clarification to the law would also ensure that there is no potential ongoing fiscal risk resulting from the inconsistency between interpretation and practice. A further objective is to ensure that this need to remove the fiscal risk is balanced with the need to treat fairly those who have taken an interpretation that is justifiable under the current law.

REGULATORY IMPACT ANALYSIS

6. The options we have identified are to maintain the status quo or to make a legislative amendment which would clarify that late payment fees are subject to GST. For base

[1] See *GST Treatment of Interest Charged on Overdue Accounts* – TIB Volume Two No. 5 December (1990).

maintenance reasons and to remove the fiscal risk resulting from the current interpretation of the rules, our preferred option is a legislative amendment.

Legislative amendment

7. Our preferred option is that the application date of an amendment is aligned with the last year in which taxpayers can possibly argue for a refund of overpaid GST. Under the GST rules, the Commissioner must refund overpaid GST if he is satisfied that the amount of the refund represents an excess over the amount properly payable and the four-year time-bar in the Tax Administration Act 1994 has not expired. However, this time-bar is extended to eight years if the GST overpaid is the result of a clear mistake or simple oversight. Under this option, the effective date would be the date that is 8 years before the date of bill introduction, say from September 2003, with application for taxable periods ending on or after that date.

8. This option would also include a savings provision that would effectively preserve the positions that taxpayers may have taken in relation to this matter, say prior to the introduction of legislative amendment.

9. We recognise that a savings provision may give rise to concerns about the potential disparity between taxpayers who have applied the current law and have not charged GST on late fees, and those who, based on their understanding of the rules have charged GST. However, on balance, we believe that this concern is outweighed by both the need to treat fairly those who have taken an interpretation that is justifiable under the current law, and the need to remove the fiscal risks outlined.

Other legislative options considered

10. Another option considered was a prospective legislative amendment – that is, an application date that would make GST chargeable on all late payment fees from the date of bill introduction. This option would prevent taxpayers from either adopting or continuing to rely on the recent interpretation of the current law from this date. Practically speaking, it means that taxpayers who had previously relied on the interpretation would not have to account for the GST that they did not charge during the periods before the introduction of the legislative change. Equally however, it would mean that taxpayers who had charged GST on late fees before the introduction of the amendment may be entitled to a refund of the output tax that they have returned to Inland Revenue. As noted above, the fiscal cost of this would be about $13.8 million.

11. We also considered a retrospective amendment without a savings provision. This option would make it clear that GST has always been chargeable on these types of fees. In practice, it would prevent taxpayers who have already charged GST on their late payment fees from claiming refunds. A retrospective application date, however, would mean that taxpayers, who had relied on an interpretation that is justifiable under current law and not charged GST on their late payment fees, would now be accountable for the outstanding output tax from the effective date of the retrospective amendment.

12. The preferred option, therefore, represents a compromise between these alternative options. The inclusion of a savings provision allays concerns about enacting retrospective

legislation while, at the same time, ensuring that the interpretation of the current law and any proposed amendments to the rules around GST and late payment fees do not pose an ongoing risk to the GST base.

Status quo

13. Maintaining the status quo is unsustainable. It results in uncertainty, creates boundary issues, and poses a significant fiscal risk to the GST base.

14. No social, environmental or cultural costs are expected to arise under any of these options.

CONSULTATION

15. We consulted with the Treasury, which agrees with our analysis. Full consultation has not been undertaken with the public so as not to signal a potential base maintenance change that could result in a behavioural change by taxpayers. We do, however, intend to inform a small number of taxpayers, who may be affected by the amendment, of the proposed legislative change closer to the date of bill introduction.

CONCLUSIONS AND RECOMMENDATIONS

16. The recommended option is a legislative amendment to the Goods and Services Tax Act 1985 that would clarify that late payment fees imposed by business on their customers are subject to GST.

IMPLEMENTATION

17. The necessary legislative change would be included in the tax bill scheduled to be introduced in September 2011, with an application date that is 8 years before the date of bill introduction, and application for taxable periods ending on or after that date. A savings provision would also apply to preserve the positions that taxpayers took before the date of bill introduction.

18. No implementation risks have been identified. The proposed changes can be done within existing administrative functions. Any legislative change in this area will be communicated. Specifically, Inland Revenue will prepare a Tax Information Bulletin item to communicate the effect of the proposed changes to taxpayers.

MONITORING, EVALUATION AND REVIEW

19. In general, the monitoring, evaluation and review of these proposals would take place under the Generic Tax Policy Process (GTPP). The GTPP is a multi stage policy process that has been used to design tax policy in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Opportunities for external consultation are also built into this stage. In practice, this would mean that these proposals would be reviewed at a time after it has had some time to work. Any changes that are needed to give the legislation its intended effect would be added to the Tax Policy Work Programme, and proposals would go through the GTPP.