

TDP 2012/1 - GST treatment of recovered dishonoured payment costs

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! Submissions have been received in response to this Technical Discussion Paper

- Joint Submission from the Institute of Chartered Accountants Australia, Tax Institute, Institute of Public Accountants, CPA Australia, Taxpayers Australia)
- Submission from the Corporate Tax Association of Australia

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GST treatment of recovered dishonoured payment costs

This paper considers the GST treatment of costs being recouped by a supplier when payment by a customer for a supply is dishonoured, resulting in the supplier incurring dishonoured fees from their financial provider which fees and associated costs are then recovered from their customer.

Goods and Services Tax Advice (GSTA) Tax Practitioner Partnership (TPP) 065 provides the current Australian Taxation Office (ATO) view on the GST treatment of on-charged dishonour fees. Publicly available information suggests different GST treatment approaches are being employed to account for such payments for the purposes of the GST law. This paper invites comment on the correct GST treatment for on-charged dishonour fees.

Purpose and status of this discussion paper

The purpose of this paper is to facilitate consultation between the ATO and the community as part of the process of developing a potential ATO view on the application of the GST law. This paper is prepared solely for the purpose of obtaining comments from interested parties. All views in this paper are therefore preliminary in nature and should not be taken as representing either an ATO view or that the ATO will take a particular view.

This paper is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this paper does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Date of issue	1 August 2012
Contact officer <i>(for comments or further information)</i>	Contact officer details have been removed as the comments period has ended.
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Introduction

1. This paper discusses the different possible GST treatments when a dishonour fee incurred by a supplier (after their customer's payment for supply is dishonoured) is recovered from their customer,¹ sometimes with other costs incurred from the dishonoured payment. We seek comments on how dishonoured payment fees that are recovered by a supplier from their customer are treated for GST purposes.
2. This paper does not consider the GST treatment of the dishonour fee imposed at first instance by a financial institution on a supplier; that is specifically dealt with under Subdivision 40-A of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), *A New Tax System (Goods and Services Tax) Regulations 1999*² (GST Regulations)³ and GSTR 2002/2⁴.
3. Publicly available information indicates Australian businesses are adopting different GST treatments when recovering dishonoured payment fees from their customers with some appearing to be contrary to the current ATO view.⁵ Different State regulatory controls may also govern or limit some service and utility suppliers recovering all costs associated with dishonoured fees for goods or services provided to customers in that State.⁶
4. An ability to recover dishonoured payment fees may exist pursuant to a contractual or statutory right, by agreement between the parties or by convention. The recovery of dishonour fees may sometimes be described in a contract as 'liquidated damages' or 'compensation', with payment occurring after the supply for which payment was dishonoured.

Purpose

5. To develop an ATO view on this issue we need to understand:
 - a. the contractual arrangements relating to recovery of dishonoured payment fees and whether the arrangements are factually similar or differ sufficiently such that the appropriate GST treatment may turn on particular facts;
 - b. the different GST approaches adopted by business on the issue and whether that relates to different factual circumstances or different interpretations of the law (and the reasons for such interpretations); and
 - c. whether there are alternative circumstances and possible GST treatments that have not been discussed in this paper, but need to be considered before the ATO forms a view on the issue.
6. The current ATO view in GSTA TPP 065⁷ provides that recovery of dishonoured payment fees may be a financial supply. For reasons discussed in this paper, this view may not be entirely correct nor complete. For example, it does not consider dishonour fees arising from a failed direct debit transaction, which differs from a dishonoured cheque.

¹ In this discussion paper, the terms 'supplier' and 'customer' means relationships where one party supplies goods or services (supplier), and the receiving party (customer) pays for those goods or services, but subsequently payment is dishonoured.

² Item 8 and item 6 of Part 1 in schedule 7 of the GST Regulations.

³ Legislative references in this paper are to the GST Act and GST Regulations, unless otherwise provided.

⁴ Item A17 and A29 of Schedule 2 indicate the dishonoured direct debit and dishonoured cheque fees are consideration for a financial interest under Item 1 in the table in subregulation 40-5.09(3) of the GST Regulations.

⁵ Many suppliers provide the terms and conditions of supply and payment on their websites. This may include information on whether GST is payable for dishonoured payment fees. For example, of eight major telecommunication providers, three indicate they do not charge GST for on-charged dishonoured fees, two indicate they charge GST for on-charged dishonour fees and four do not state their GST treatment; of five gas and electricity providers, three indicate they charge GST for on-charged dishonour fees and two do not state their GST treatment; of two pay television providers, one indicates they charge GST for on-charged dishonour fees and one does not specify the GST treatment.

⁶ For example, clause 7.10.2. of the South Australian Energy Retail Code limits the ability of a retailer to recover from a small customer (as defined in the Code) anything more than the amount of the fee the retailer has incurred as a result of a dishonour by the small customer.

⁷ See Appendix 1.

Structure of this paper

7. Part I discusses our current understanding of the payment processes by way of cheque and direct debit, and the dishonouring of payments.
8. Part II considers the relevant GST provisions, whether recouped dishonoured payment fees are consideration for an 'interest' within Division 40 of the GST Regulations, and also includes discussion of GSTA TPP 065.
9. Part III discusses possible alternative GST treatments of dishonour fees recovered from the customer by the supplier, being:
 - Alternative View 1 – the provision of a stand alone facilitation service;
 - Alternative View 2 – damages for a contractual breach;
 - Alternative View 3 – additional consideration for the underlying supply.
10. Part IV summarises what has been discussed in the paper, before seeking your views on how recovered dishonoured fees should be treated for GST purposes, noting some particular points for discussion.

Part I

11. In this Part, we discuss our current understanding of the payment processes by way of cheque and direct debit, and the dishonouring of payments.

Dishonoured transactions

12. The Reserve Bank of Australia has overall regulatory responsibility for payment systems in Australia,⁸ overseeing the payments' system via the Payments System Board.⁹ Clearing payments by way of cheques and direct debits is co-ordinated by the Australian Payments Clearing Association (APCA).¹⁰
13. Suppliers may offer customers an infrastructure for bill payment, including payment by way of cheque or direct debit. The terms and conditions of different payment options are usually governed by an agreement or contract for the relevant supply.¹¹
14. Suppliers enter arrangements with financial institutions to facilitate customer payments. Under these arrangements, any fees associated with dishonoured payment by the customer are charged to the supplier by the financial institution.
15. The ability of the supplier to recover a dishonoured payment fee will depend on the relevant agreement for the underlying supply. Examples of contractual clauses used by suppliers for the recovery of dishonoured payment are found at Appendix 4. Such agreements may provide:
 - a. a term that specifies upon a dishonour event occurring in relation to a cheque or direct debit payment the customer is liable to pay the relevant dishonour fee;
 - b. the contract is silent on the customer's obligation to ensure payments are honoured, but the terms provide that failure to pay by the due date will result in the customer being in breach of the contract and be liable for late payment fees or interest;

⁸ See <http://www.rba.gov.au/payments-system/legal-framework/index.html>.

⁹ See www.rba.gov.au/payments-system/about.html.

¹⁰ Found at www.apca.com.au.

¹¹ Other payment options may be offered, such as Bpay, direct credit, EFTPOS, PayPal, but as the customer's payment is declined when they attempt to pay for the goods or services by these means if there are insufficient funds, there is no dishonoured payment to the supplier.

- c. terms that provide when payment is made by direct debit the customer agrees to a Direct Debit Request Authority, whereby the customer agrees to have sufficient cleared funds in their account to meet any direct debit, and a dishonour fee is payable for a failed direct debit;
- d. implied terms that the drawer has authority to draw the cheque and the cheque will be met on presentation;¹²
- e. industry specific statutory rights to recover bank dishonour fees from their customer including, in some cases, an additional administrative fee.¹³

16. A dishonour fee arises when a customer's payment is not honoured by the customer's financial institution as the customer has insufficient cleared funds or available credit. A dishonour fee is typically associated with dishonoured cheques or direct debit payments from a savings' account with a financial institution or from a credit card account.

17. A dishonour fee differs from a late payment fee: a dishonour fee is imposed by the financial institution when a payment authorisation is presented but there are insufficient funds or credit, whereas a late payment fee is imposed by the supplier for the delay in payment when payment is not made by the due date.

18. Being able to recover the loss from a dishonoured payment under an agreement with customers does not preclude the supplier recovering the dishonoured cheque payment as a separate cause of action under section 76 of the *Cheques Act 1986* (Cth) (Cheque Act).¹⁴

19. An amount awarded under the Cheques Act for dishonoured payment is deemed to be liquidated damages.¹⁵ This amount comprises the value of the dishonoured cheque and any interest awarded but does not include any on-charged dishonour fee or associated costs.¹⁶

20. This discussion paper does not further consider the cause of action under the Cheques Act. This paper addresses situations where a dishonour fee following payment by cheque or direct debit is contemplated under the agreement for an underlying supply or relates to a statutory right of recovery of the dishonour fee for an underlying supply.

Payment by way of cheque

21. Logan J considered the effect of cheque payments in *DCT v. BK Ganter Holdings Pty Ltd*¹⁷ by reference to the High Court decision of *National Australia Bank v. KDS Construction Services Pty Ltd*¹⁸ as follows:

... when a cheque is given in payment of a debt, it operates as a conditional payment. The payment is subject to a condition that the cheque be paid on presentation. If it is dishonoured the debt revives. Although it is sometimes said that the remedy for the primary debt is suspended, the suspension is no more than a consequence of the conditional nature of the payment: *Tilley v. Official Receiver in Bankruptcy*¹⁹... The condition is a condition subsequent so that, if the cheque is met, it ranks as an actual payment from the time it was

¹² Tyree, A, *Banking Law in Australia* (6th edition), LexisNexus Butterworths, Chatswood, paragraph 7.80 citing R v. Page (1971) 2 QB 330.

¹³ For example clause 7.5(a) of the Energy Retail Code. The code is issued under section 36 of the Electricity Industry Act 2000 (Vic) and section 43 of the Gas Industry Act 2001(Vic) <http://www.esc.vic.gov.au/getattachment/06661f37-494a-4f8c-8604-7fdf33a27dd2/Energy-Retail-Code-Version-10.pdf> SA Energy Retail Code allows recovery of bank fees for cheque direct debit and credit card. QLD Electricity Code provides for recovery of the bank fees and a reasonable additional administrative fee. From 1 July 2012, the National Energy Customer Framework will transfer State and Territory based regulation to a single National Regulatory system which may result in these Codes being changed or replaced.

¹⁴ See Appendix 2. This cause of action is an alternate right, not a cumulative right, to recover the loss associated with the dishonoured cheque; judgment or satisfaction extinguishes the alternate cause of action.

¹⁵ Subsection 76(3) of the Cheques Act.

¹⁶ Pursuant to subsections 76(1) and (2) of the Cheques Act.

¹⁷ [2008] FCA 1730 at paragraph 13.

¹⁸ [1987] HCA 65; (1987) 163 CLR 668 at 676.

¹⁹ [1960] HCA 86; (1960) 103 CLR 529, at pp 532 – 533, 535 – 536, 537.

given. Subject to non-fulfilment of the condition subsequent, the payment is complete at the time when the cheque is accepted by the creditor: *Thomson v. Moyse*²⁰...

22. Payment by cheque provides conditional payment which does not extinguish the debt; it suspends the debt. If payment is met, it is from the time the cheque was accepted by the supplier. If payment is not met, the debt was never extinguished.²¹

Payment by direct debit

23. Direct debit transactions use a direct entry system called the Bulk Electronic Clearing System (BECS) to settle payments between financial institution accounts.²² Financial institutions are participants in the direct entry payment system and are bound by the rules and guidelines established by the APCA. According to the APCA, the direct entry system:

...is an electronic payment system typically used by businesses to send or collect regular payments from large numbers of their employees or customers. Payments collected from customers' banking accounts ... are known as 'direct debits' and payments sent to customers' banking accounts are known as 'direct credits'.²³

24. To use direct debits with customers, the supplier requires the customer to provide a direct debit authority to establish the arrangement. Once the authority is held, the supplier can initiate direct debits on the customer's account within the terms of that authority. In contrast to cheques, which have a statutory framework and are a form of negotiable instrument, direct debits are a type of payment instruction the account holder provides to their financial institution. The account holder (customer) authorises another party (payee/supplier) to initiate the payment instructions on its behalf. As such, use of the direct entry system for payment of supplies is governed by the contractual relationships between the parties.

25. Although technically different, payment by way of direct debit is similar to payment by way of cheque.²⁴ Payment can be stopped on the instruction of the payer, payment requires authorisation from the payer, the payee's financial institution presents the payment instruction to the payer's financial institution, and there is usually a delay in the unconditional honouring of the payment, unlike payment by cash.

26. Perhaps most relevantly, cheques and direct debits both involve the supplier presenting the payment instruction (being either the cheque or direct debit instruction) to their financial institution, where there is a risk the cheque or direct debit instruction will be dishonoured by the customer's financial institution if there are insufficient funds. When this occurs, both payment methods may result in the supplier being charged a dishonour fee by their financial institution.

Part II

27. GSTA TPP 065 provides that the transaction for recovery of dishonoured payment fees may be a financial supply. This Part considers the relevant GST provisions, whether the recovery of dishonoured payment fees are consideration for an 'interest' within Division 40 of the GST Regulations, and includes discussion of GSTA TPP 065.

Relevant GST provisions

28. This section of the discussion paper considers whether the dishonour fee that is recoverable from, or paid by, the customer is consideration for a supply and if so, whether that

²⁰ (1961) AC 967 at p 1004.

²¹ Further authority for the conditional nature of cheque payment is found in *Marreco v. Richardson* [1908] 2 K.B. 584 at 592-593; *Godfrey v. Sevenoaks* (1957) 75 WN (NSW) 487; *Saffron v. Societe Miniere Cafrika* (1958) 100 CLR 231 at 244 and *Re Romer & Haslam* [1893] 2 QB 286 at 296.

²² The rules are found in the BECS Regulations at http://www.apca.com.au/docs/payment-systems/beans_regulations.pdf.

²³ See http://www.apca.com.au/docs/payment-systems/direct_entry_fact_sheet.pdf.

²⁴ This was considered by the Court in *Esso Petroleum Company Ltd v. Milton* [1997] EWCA Civ 927 when assessing whether set-off was available between a liquidated debt and an unliquidated counterclaim.

supply is a financial supply. We next discuss what are ‘supply’, ‘consideration’ and financial supplies.

What is a ‘supply’ for GST purposes?

29. The word ‘supply’ is broadly defined. Section 9-10 provides the meaning of ‘supply’, with section 9-5 defining what supplies are taxable supplies. Of relevance to this discussion paper, under section 9-10 a supply may include:

- a. a supply of goods or services;
- b. a creation or grant of any right;
- c. a financial supply;
- d. an entry into, or release from, an obligation to do anything, or to refrain from an act.

30. GSTR 2006/9 provides the ATO view on the meaning of ‘supply’. This ruling identifies propositions for characterising supplies and analysing more complex transactions. The propositions relevant to this discussion paper are:

- a. a transaction may involve two or more supplies;²⁵
- b. to ‘make a supply’ an entity must do something;²⁶
- c. ‘supply’ usually requires something to be passed from one entity to another;²⁷
- d. creation of expectations alone does not establish a supply;²⁸
- e. the agreement is the logical starting point to work out the entity making the supply and the recipient of the supply;²⁹
- f. transactions that are neither based in a binding agreement nor involve a supply of goods, services or some other thing, do not establish a supply;³⁰
- g. one set of activities may constitute the making of two or more supplies;³¹
- h. the total fact situation determines the nature of the transaction, the entity making the supply and the recipient of the supply.³²

What is ‘consideration’?

31. ‘Consideration’ in the GST Act is wider than under the general principles of contract law and is an ‘extended statutory concept’.³³ GSTR 2001/4 summarises the meaning of ‘consideration’ as follows:

74. A supply is a taxable supply, if, among other things, the supply is made for consideration. Consideration is defined in section 195-1 to mean ‘any consideration, within the meaning given by section 9-15, in connection with the supply’. The meaning given to consideration in section 9-15 extends beyond payments to include such things as acts and forbearances. It may include payments made voluntarily, and payments made by persons other than the recipient of a supply.

75. Section 9-15 further provides that a payment will be consideration for a supply if the payment is ‘in connection with’ a supply and ‘in response to’ or ‘for the inducement’ of a

²⁵ Discussed at paragraphs 67 – 70 of GSTR 2006/9.

²⁶ Discussed at paragraphs 71 – 79 of GSTR 2006/9.

²⁷ Discussed at paragraphs 92 – 94 of GSTR 2006/9.

²⁸ Discussed at paragraphs 102 – 111 of GSTR 2006/9.

²⁹ Discussed at paragraphs 119 – 122 of GSTR 2006/9.

³⁰ Discussed at paragraphs 123 – 129 of GSTR 2006/9.

³¹ Discussed at paragraphs 217 – 221S of GSTR 2006/9.

³² Discussed at paragraphs 222 – 246 of GSTR 2006/9.

³³ *AXA Asia Pacific Holdings Ltd v FC of T* [2008] FCA 1834 at 90.

supply. Thus, there must be a sufficient nexus between a particular supply and a particular payment, which is provided for that supply, for there to be a supply for consideration.

76. It follows that there are two elements to the definition of consideration. The first is the payment by one entity to another. The second element is the nexus that must be established between the payment and a supply.

32. There should be a sufficient nexus between the supply and the consideration,³⁴ which is objectively determined.³⁵ Regard needs to be had to the true character of the transaction, which is not characterised by the description given to the arrangement, but by looking at all the transactions entered into and the circumstances in which the transactions are made.³⁶

33. A payment may be consideration for a supply without the supplier having an enforceable entitlement to receive that payment.³⁷ Payment may relate to an earlier supply where there is sufficient nexus to that earlier supply.³⁸ Payment may also relate to an obligation that is not a supply; such as a legal obligation or liability.³⁹

34. Where a payment is described as 'damages', the fundamental question is still whether the amount paid is consideration for a supply.⁴⁰

Is there a financial supply?

35. GST is payable on taxable supplies under subsection 7-1(1). To be a taxable supply, that supply, as defined in section 9-10, must be made for consideration in accordance with section 9-5. Consideration includes 'any payment, or any act or forbearance, in connection with a supply of anything'.⁴¹

36. In this context, it is necessary to consider whether any supply made is a 'financial supply'⁴² as this type of supply is not a taxable supply.⁴³ Financial supplies are input taxed⁴⁴ except to the extent the supply would also be GST-free.⁴⁵ Subsection 40-5(2) provides that 'financial supply' has the meaning given by the GST Regulations.

37. Financial supplies are identified under regulations 40-5.09 and 40-5.10, unless excluded by regulation 40-5.12.⁴⁶

38. An 'interest' is only a financial supply under subregulation 40-5.09(1) if the interest is recognised at law or in equity as property,⁴⁷ and there is:

- a. the provision, acquisition or disposal of such interest;
- b. consideration being provided for that interest;
- c. an enterprise is connected with Australia in respect of that interest;
- d. a supplier who is registered or required to be registered; and
- e. the supplier is a financial supply provider for that interest.

³⁴ See paragraphs 89 – 96 in GSTR 2001/4 and paragraphs 64 – 72 in GSTR 2001/6

³⁵ See paragraph 180 of GSTR 2006/9.

³⁶ See paragraph 18 of GSTR 2006/9.

³⁷ *TT-Line Company Pty Ltd v. Commissioner of Taxation* (2009) 74 ATR 771; *Vidler v. FC of T* [2009] AATA 395 at paragraph 69. Although the latter case went on appeal to the Full Federal Court it was not in relation to this point.

³⁸ See paragraph 101 of GSTR 2001/4.

³⁹ Such as a damages award following court action, or the payment of taxes. Damages payments are discussed under GSTR 2001/4, and tax payments are specifically covered by Division 81 of the GST Act.

⁴⁰ This is discussed in GSTR 2001/4 and at paragraphs 64 and 65 of GSTR 2009/3 in relation to the treatment of cancellation fees.

⁴¹ Paragraph 9-15(1)(a) of the GST Act.

⁴² Paragraph 9-10(2)(f) of the GST Act.

⁴³ Section 9-5 of the GST Act.

⁴⁴ Subsection 40-5(1) of the GST Act.

⁴⁵ Subsection 9-30(3) of the GST Act.

⁴⁶ Regulation 40-5.08 of the GST Regulations.

⁴⁷ Regulation 40-5.02 of the GST Regulations.

39. The table in subregulation 40-5.09(3) identifies types of interest that may be a financial supply. For the purposes of this discussion paper, this includes:

- a. a debt, credit arrangement or right to credit;⁴⁸ and
- b. an indemnity.⁴⁹

40. GSTR 2002/2 provides the ATO view of what are financial supplies for the purposes of the GST Act and the GST Regulations. The term 'interest' is taken to be very broad, even taking into account the use of the word 'property' and includes rights arising under a contract.⁵⁰

41. To consider the existing ATO view under GSTA TPP 065, we next consider whether the charging of dishonour fees is consideration for the supply of a financial interest in or under:

- a. a debt;
- b. a credit arrangement; or
- c. an indemnity.

Are dishonour fees consideration for a financial 'interest'?

Are dishonour fees consideration for an interest in a debt?

42. Whilst there is no statutory definition of 'debt', there is authority the term 'debt' used in the Corporations Act conveys the ordinary meaning of that word.⁵¹ Hence, insolvency law offers judicial consideration of the existence, timing and extent of debts in the ordinary meaning.

43. The essence of a debt is an obligation of one person to pay a certain or liquidated sum to another.⁵² A debt paid but subsequently set aside does not extinguish that debt.⁵³

44. The type of transaction, and arrangement between the parties, may indicate the existence and timing of a debt.⁵⁴ For example, a rent debt is incurred when the lease is entered,⁵⁵ whereas a debt is incurred for the sale of goods at the date of delivery⁵⁶ unless there is an agreement to the contrary,⁵⁷ or there is a special order for goods being supplied in which case the debt is incurred with that order.⁵⁸ An interest related debt is incurred when the contract to pay interest was made.⁵⁹

45. A positive act is required for a debt to be 'incurred',⁶⁰ although obligations at law, such as an indemnity, can bring a debt into existence or create a contingent debt.⁶¹

46. Although debts may be 'incurred' at a particular time, the time for payment may differ. Whether or not a debt is due for payment is determined by reference to the legal agreement between the parties,⁶² including any indulgences or extensions granted by creditors.⁶³

⁴⁸ At Item 2 of the table.

⁴⁹ At Item 7 of the table.

⁵⁰ Paragraph 79 of GSTR 2002/2.

⁵¹ Per Branson J in *Molit (no. 55) Pty Ltd v. Lam Soon Australia Pty Ltd (Administrator appointed) & Anor (No. 2)* [1996] FCA 659; *HI Diagnostics Pty Ltd v. Psycadian Ltd* [2005] WASC 234; *Commonwealth Bank of Australia v. Butterell* (1994) 35 NSWLR 64.

⁵² Per Master Newnes in *HI Diagnostics Pty Ltd v. Psycadian Ltd* [2005] WASC 234 citing *Young v. Queensland Trustees Ltd* [1956] HCA 51; (1956) 99 CLR 560 at 567.

⁵³ *Amateck & Ors v. Botman & Anor* (1995) 13 ACLC 1729 at 1741.

⁵⁴ See Hodgson J in *Standard Chartered Bank of Australia Limited v. Antico & Ors* (1993) 13 ACLC 1381 at 1429.

⁵⁵ *Russell Halpern Nominees Pty Ltd v. Martin & Anor* (1986) 4 ACLA 393.

⁵⁶ *Hussein v. Good* (1990) 8 ACLC 390 at 398.

⁵⁷ See *Rema Industries and Services Pty Ltd v. Coad & Ors; Re Taspace Thermoforming Pty Ltd* [1992] FCA 114; (1992) 107 ALR 374.

⁵⁸ *Leigh-Mardon Pty Ltd v. Wawn* (1995) 13 ACLC 1244 at 1248.

⁵⁹ *John Graham Reprographics v. Steffens* (1987) 12 ACLR 779 at 784.

⁶⁰ *Hussein v. Good* (1990) 8 ACLA 390; *Geraldton Building Co v. Woodmore* (1992) 8 ACSR 585 at 596.

⁶¹ *Hawkins v. Bank of China* (1992) 26 NSWLR 562; *Shepherd v. ANZ Banking Group Ltd* [1996] NSWSC 115; (1996) 20 ACSR 81 at 89. For example, legal obligations under revenue law or by way of restitution can create a debt.

⁶² *Pioneer Concrete Pty Ltd v. Ellston* (1985) 10 ACLR 289 at 301; *Carrier Air Conditioning v. Kurda & Ors* (1993) 11 ACSR 247; *Lee Kong & Ors v. Pilkington (Australia) Limited* (1997) 25 ACSR 103 at 112; *Credit Corp Pty Ltd v. Atkins* [1999] FCA 335 at paragraph 45 - 49.

47. From a GST perspective, a typical transaction involves the supplier providing goods or services to the customer and in return the customer owes a debt to the supplier. When payment is made by the customer by tendering a cheque or executing a direct debit instruction, the debt remains the property of the supplier until the cheque or direct debit has cleared at which time the debt is extinguished.

48. When the cheque or direct debit is dishonoured the debt remains outstanding. Payment by way of cheque merely suspends the debt. When the cheque is dishonoured the original debt owed by the customer to the supplier remains payable. Payment by way of direct debit does not extinguish a debt unless payment is made by the customer's bank.

49. When considering whether an 'interest' in a financial supply is provided or created under GST law, it appears the supplier has not received any property in a debt or a new debt from the customer; the original debt never ceased to exist and remained the property of the supplier.

50. Accordingly, payment of a dishonour fee by the customer cannot be consideration for the supply of an interest in a debt.

Are dishonour fees consideration for an 'interest' in credit?

51. A debtor / creditor relationship may exist when a debt is incurred, but this does not mean credit is provided for such debt. Credit only arises with consent or an intention that payment of the debt is deferred, rather than being immediately payable.⁶⁴

52. Accounts or running accounts may be utilised where the supplier provides the customer with time to pay or trade credit for the supply of goods or services. In commerce, the use of a running account may indicate there is a continuing relationship of debtor and creditor with an expectation further debts and credits will arise to reflect ongoing transactions between the parties. The fact payment does not close the account suggests that dealings are continuing, with goods or services provided and paid for on credit.⁶⁵

53. Payment made on a running account is not necessarily consideration for the supply of a financial interest. Where a contract contemplates interest or other charges being payable if payment is not made on time, a credit arrangement may exist under item 2 of the table in subregulation 40-5.09(3). Payment of the additional charges for late payment becomes the consideration for the supply of an interest in a credit arrangement.⁶⁶ The credit arrangement existed before the customer's payment for the supply dishonoured; the dishonour event results in the debt becoming overdue. Any dishonour fee paid by the customer is not provided for late payment of the debt but is provided for the dishonour event.

54. A dishonoured payment may result in a debt being paid late. If credit was originally provided by the supplier for the supply and a debt becomes due for payment, the underlying debt remains payable if payment subsequently dishonours. Additional credit is not provided when payment dishonours. Altering the due date for payment does not create a new debt.⁶⁷

55. If following a dishonour event the supplier agrees to defer the due date for payment of an existing debt, the supplier may provide credit if the earlier arrangement is replaced by a different

⁶³ *3M Australia v. Kemish* (1986) 10 ACLR 371 at 378; *Taylor v. ANZ Banking Group* (1988) 13 ACLR 780 at 784. Accounting standards may exist for present, future and contingent liabilities pursuant to annual reporting obligations required of companies under the Australian Accounting Standards Board.

⁶⁴ See McTiernan J in *Herbert v. The King* (1941) 64 CLR 461 at 467; Macrossan CJ in *R v. Brown* (1989) 46 A Crim R 28 at 30-31 citing Kitto J in *Tilley v. Official Receiver in Bankruptcy* [1960] HCA 86; (1960) 103 CLR 529 at 535; *Commissioner of Taxation v. Radilo Enterprises Pty Ltd* (1997) 72 FCR 300 at 312 per Sackville and Lehane JJ.

⁶⁵ *Queensland Bacon Pty Ltd v. Rees* [1966] HCA 21; (1966) 115 CLR 266 at 286; *Richardson v. The Commercial Banking Co of Sydney Ltd* [1952] HCA 8; (1952) 85 CLR 110. *Airservices Australia v. Ferrier* ("Compass Airlines case") [1996] HCA 54; (1996) 185 CLR 483.

⁶⁶ See paragraph 87 of GSTR 2003/11 and paragraph 30 of GSTR 2000/19.

⁶⁷ *Zoverton v. Commissioner of Stamp Duties* (1988) 89 ATC 4339; *Caltex v. FCT* [1960] HCA 17; (1961) 106 CLR 205 at 218, 227, 231; *Tallerman and Co. v. Nathans Merchandise* [1957] HCA10; (1957) 98 CLR 93 at 122-3, 135, 142.

agreement. Cancelling an existing agreement and creating a new agreement for payment of a debt are within the scope of regulation 40-5.09.⁶⁸

56. Whether credit is provided depends on the agreement between the parties. Providing a right to credit will be a financial supply if it creates recognisable legal or equitable property and invokes regulation 40-5.09.⁶⁹

57. When considering whether an ‘interest’ in or under a credit arrangement arises under GST law from a customer’s payment being dishonoured, it appears:

- a. the right to recover the dishonour fees, and any right to recover amounts for late payment of a debt, both exist under the contract for supply of the goods or services;
- b. the event of a payment dishonouring can cause a payment to become overdue, which may result in late payment fees or interest being payable by the customer, as well as the dishonour fees being recoverable from the customer;
- c. the obligation to make a late payment fee or to pay interest on an overdue debt may create an interest in a credit arrangement,⁷⁰ with payment of such amount being consideration for the supply of an interest in a credit arrangement;
- d. the obligation to make dishonoured payment fees is unrelated to the due date for payment and any associated late payment fees, with payment of the dishonour amount being for the dishonoured payment event;
- e. there is an insufficient nexus with the supply of an ‘interest’ in or under a credit arrangement for the dishonoured payment fee to be treated as consideration for an ‘interest’ in a credit arrangement.

58. The dishonour event is not a supply of an ‘interest’ in or under a credit arrangement, and payment of the dishonour fees by the customer cannot be consideration for a financial supply relating to a credit interest.

Are dishonour fees consideration for an indemnity ‘interest’?

59. Paragraph 70 of GSTR 2006/1 provides an indemnity for the purposes of regulation 40-5.09 is:

... an arrangement involving three parties. In an indemnity, the surety takes primary responsibility for an obligation arising in relation to a third party. That is, the creditor may recover directly from the surety, regardless of whether the principal defaults.

60. This is to be contrasted with an indemnity clause / term under a contract, the ‘contractual indemnity’, which typically takes the form of an enforceable promise to hold a person harmless from loss for events not ordinarily covered by insurance. Such contractual indemnities, because of their bi-lateral nature, are not indemnities within the scope of regulation 40-5.09.

61. The right to recover dishonour fees under a ‘contractual indemnity’ is not the supply of a financial interest for the purposes of regulation 40-5.09. Accordingly, payment of dishonour fees by the customer pursuant to a ‘contractual indemnity’ is not consideration for the supply of an interest in or under an indemnity under regulation 40-5.09.

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62. The dishonour fee charged directly to a supplier or customer by an Australian authorised deposit taking institution in the course of its banking business is an input taxed financial supply.⁷¹

⁶⁸ By virtue of regulations 40-5.03, 40-5.04 and 40-5.05.

⁶⁹ By virtue of regulations 40-5.02 and 40-5.03.

⁷⁰ GSTR 2000/19 contemplates a supplier may provide an interest in a credit arrangement and make a financial supply when late payment fees or interest become payable.

⁷¹ By virtue of Item 1 in the table in subregulation 40-5.09(3).

63. However, for the reasons discussed above, where the dishonour fee charged to the supplier for the customer's dishonoured payment is recovered from the customer, payment of the dishonour fees by the customer is not consideration for an 'interest' in or under a debt, a credit arrangement or an indemnity, and is not a financial supply for the purposes of the GST law.

64. The customer's payment of a dishonour fee may be consideration for a supply, other than a financial supply, if it is consideration for some other supply or an existing supply. Alternatively, payment may be for no supply at all. Each of the possible alternate GST treatments are considered in Part III below.

Part III

65. Under this Part, we discuss possible alternative GST treatments of dishonour fees recovered from the customer by the supplier. Alternative view 1 considers whether the recoverable dishonour fees are for the provision of a stand alone facilitation service. Alternative view 2 considers whether the recoverable dishonour fees are for a contractual breach. Alternative view 3 considers whether the recoverable dishonour fees are additional consideration for the underlying supply.

Alternative view 1 – provision of a separate service

66. Ordinarily, payment of money is not a supply although payment may be consideration for a supply.⁷² Whether separate consideration is provided for a supply depends on the facts of the transaction. Separate itemisation of fees on an invoice may indicate there is a separate service for separate consideration, but that is not conclusive.⁷³

67. In a European Union VAT case where a supplier of mobile phones offered payment options to its customers, resulting in different charges depending on the payment method chosen by the customer, the Court found that whilst the provision of phone services and the provision of payment options may be separate services, they should be treated as a single transaction where they were not independent. The Court considered the payment service was ancillary to the principal phone service. Any payment attributable to the invoicing and payment infrastructure was not consideration for a separate supply but was part of a single transaction when the circumstances of the transaction were considered.⁷⁴

68. Where a customer's payment dishonours, the fact situation reveals:

- a. the customer's obligation to pay and the supplier's right to recover the dishonoured payment fee arises from an existing contractual agreement between the supplier and the customer;
- b. the supplier needs to undertake processing and administrative functions to facilitate the different payment options offered to its customers;
- c. the payment processing and administrative functions are intrinsic and ancillary to the supplier's enterprise – in other words, the supplier performs these functions to process payments received for supplies irrespective of whether or not payment dishonours;
- d. where there is an ongoing relationship of debtor / creditor, any fees charged to the customer may appear on a running account or invoice issued to the customer by the supplier;
- e. the supplier may charge customers a fee or interest for late payment, which amount charged will be treated for GST purposes as the supply of a credit arrangement;⁷⁵

⁷² Subsection 9-10(4) of the GST Act.

⁷³ Paragraph 136 of GSTR 2002/2.

⁷⁴ *Everything Everywhere Ltd (formerly T-Mobile (UK) Ltd) v. Revenue and Customs Commissioners* [2011] STC 316.

⁷⁵ See paragraph 32 of GSTR 2000/19.

- f. the supplier may charge customers an administrative fee associated with the type of payment being used by the customer, such as credit card, where the fee may be treated for GST purposes as part of the cost of the underlying supply;⁷⁶
- g. the additional action performed by the supplier when the customer's payment dishonours is notifying the customer of the dishonour event and demanding payment for the supply together with any dishonour fees payable under the agreement.

69. To make a supply, an entity must do something which results in something passing to another entity. The fact situation suggests nothing additional is provided, conferred, furnished or given which was not already available under the agreement between the supplier and customer.

70. Pursuant to this alternative view, in the absence of separate and independent services being provided for payment of the dishonoured payment fees, the payment of dishonoured payment fees cannot be consideration for a separate supply for the purposes of the GST Act.

71. If payment of the dishonour fee by the customer is not for a separate supply, but is required to be made by the customer, it must be payable for a contractual breach or for the original supply of goods or services for which payment originally dishonoured.

Alternative view 2 – damages for contractual breach

What are damages?

72. According to the *Osborn's Concise Law Dictionary* 'damages' are the compensation or indemnity for loss suffered from a tort, or breach of contract, or breach of statutory duty committed by another party. The principle is the injured party is put as nearly as possible in the same position, so far as money can, as if they had not been injured. Damages for the same cause of action are recoverable once.

73. A customer who fails to make payment in accordance with their agreement with the supplier is likely to be in breach of that agreement. The remedy available to the supplier is reliance on contractual or statutory rights to recover any loss suffered from the customer's dishonoured payment. The supplier may also claim loss from the customer for the administrative costs incurred in relation to the dishonoured payment.

74. The contractual right to recover losses associated with dishonoured payment may be described as 'agreed damages' or 'liquidated damages' clauses. This right is enforceable provided the damages claimed are a genuine pre-estimate of the loss or damage, and are not a penalty. A penalty is generally out of all proportion to the damage likely to be suffered, and is in the nature of punishment for non-observance of contractual obligations.⁷⁷

75. The amount payable as agreed or liquidated damages is the genuine pre-estimate of loss likely to be suffered if the payment obligation is breached following a dishonoured payment. The law allows parties to make a genuine pre-estimate of loss flowing from a contractual breach.⁷⁸ Provided the parties agreed the dishonoured payment fee was payable as the pre-estimate of loss and damage flowing from the breach, it is compensatory in nature.

Are damages payable for a supply?

76. A payment of damages arising from a breach of contract may not relate to an earlier or current supply. Where the damages do not relate to an earlier or current supply, payment of damages will not be consideration for a supply. Where damages are awarded for an earlier or current supply, payment of the damages will be consideration for a supply.⁷⁹

⁷⁶ See *Waverley Council v. FC of T* 2009 ATC 10-095.

⁷⁷ *O'Dea v. Allstates Leasing System* (1983) 152 CLR 359; *Amev-UDC Finance Ltd v. Austin* (1986) 162 CLR 170.

⁷⁸ See *Ringrow Pty Ltd v. BP Australia Pty Limited* [2005] HCA 71; (2005) 224 CLR 656.

⁷⁹ See GSTR 2001/4.

77. The GST treatment for amounts paid as damages should not differ depending on whether such amounts are payable pursuant to a liquidated damages clause, under an out of court settlement, or pursuant to a court order.⁸⁰

78. A useful illustration of where payment for breach of contract may not be related to a supply is found in GSTR 2003/11 which discusses payments for early termination of leases. Where the lessee exercises a contractual or statutory right to early termination in accordance with their lease, an early termination payment may result in a change in consideration provided for the earlier supply, or may result in a taxable supply if part of the payment transfers title in goods.⁸¹ Where early termination arises from a default caused by the lessee's breach of the contract, paragraph 72 of GSTR 2003/11 provides:

A payment received to compensate the lessor for genuine damage or loss flowing from early termination as a result of a default by the lessee is not consideration for a supply... The lessor merely exercises its right to terminate and the payment is in the nature of damages for the lessee's breach of the lease which gave rise to the lessor's right to terminate.

79. Payments described as compensation or damages can be consideration for a supply. In *FCT v. American Express Wholesale Currency Services Pty Ltd* [2010] FCAFC 122, Dowsett J observed that promises by a cardholder to pay late payment fees or liquidated damages were consideration for a supply made by American Express (AMEX) to the cardholder. These observations were not disturbed by the High Court appeal and are consistent with the Commissioner's view that these payments are consideration for financial supplies.⁸²

80. The circumstances in the AMEX case illustrates a payment may arise from, and have a connection with a breach of contract, but still retain a connection with an underlying supply. In the AMEX case the 'liquidated damages' payment was part of the overall credit arrangement, or right to credit under the credit contract as the cardholder effectively obtained a further payment deferral.

81. This is similar to late payment interest under a contract; although the interest obligation arises when a customer breaches its contractual obligation to pay on time, and the interest payment may compensate for the time delay in payment, late payment interest is not damages for the contractual breach. The interest payment would be consideration for the supply of an interest in a credit arrangement.⁸³

82. In the context of a late payment breach there is a clear nexus between the payment being made and the customer obtaining a deferral of payment that is part of the supply of credit. In contrast, the dishonoured payment and associated breach do not create, provide, or give rise to a further supply.

83. Where the customer's payment dishonours, the fact situation indicates:

- a. the customer's obligation to pay and the supplier's right to recover the dishonoured payment fee arises from an existing contractual agreement between the supplier and the customer;
- b. the obligation to pay the dishonour fee follows payment being tendered or authorised by the customer, for the supply of goods or services, and that payment subsequently dishonours;
- c. the dishonouring event, and resultant dishonour fees, do not change the fact goods or services have been supplied to the customer, and payment for those goods or services is still owing;

⁸⁰ See paragraph 103 of GSTR 2003/11 and GSTR 2001/4.

⁸¹ See commentary in GSTR 2003/11 and ATO ID 2006/3.

⁸² Emmett J in the first instance took the opposite view and the majority of the Full Federal Court did not discuss the issue due to the nature of the arguments led by the Commissioner. As indicated in the Decision Impact Statement the Commissioner maintains the view expressed in GSTR 2002/2 and GSTR 2000/19 that such payments are consideration for financial supplies.

⁸³ See paragraph 87 of GSTR 2003/11.

- d. the dishonoured payment fee has a nexus with a breach of the governing agreement for the supply of goods or services between the supplier and customer;
- e. the dishonour event follows action by the customer's bank after the supplier's bank presents the cheque or direct debit payment request.

84. The dishonoured payment fee arises when the customer fails to honour payment made for the supply. The dishonour fee payable is clearly contemplated under the agreement between the supplier and customer when the supply is made and payment tendered. However, payment is made for the dishonouring event rather than for a particular supply. Compensation or damages are only subject to GST if they relate to a taxable supply of goods or services.⁸⁴

85. Under this Alternative view, it is the dishonour event, being the breach of agreement to honour payment, which gives rise to the payment by the customer. The nexus is with the dishonour event and not the supply of goods or services. Accordingly, any dishonour fees payable by the customer would not be consideration for any supply.

Alternative view 3 – additional consideration for earlier supply

Is there a nexus with an earlier supply?

86. Contractual agreements will establish the mutual obligations and rights of the parties to the contract. In a contract for the supply of goods or services, this may include obligations and rights relating to payment for the goods or services, including payment for an event of dishonour.

87. Inherent in any payment made by way of cheque or direct debit, there is an expectation the customer will have sufficient funds or available credit to satisfy any cheque drawn or to honour any direct debit authority provided to the supplier.

88. With each payment made by way of cheque or direct debit for the goods or services supplied, the customer contractually promises to pay any dishonoured payment fee. In return for supplying the goods or services, the supplier accepts such payment knowing it may dishonour. If payment dishonours, the supplier can recover any dishonoured payment fees as part of the promised payment for making the supply; payments made by the customer are consideration for that supply.

89. It is commercially inherent in accepting certain payment methods that some payments may dishonour. Any agreement between the parties to quantify the supplier's costs which can be recovered pursuant to contractual or statutory rights is driven by commercial necessity.

90. Another way at looking at this issue is any dishonour fee charged to the supplier by its financial institution for the dishonour of a customer's payment is an administrative cost to the supplier. The administrative or operational costs for processing payments are part of the enterprise conducted by the supplier when supplying goods or services to customers.

91. The recoverable administrative costs for dishonoured payment fees may be described by the supplier and customer as 'liquidated damages'. To the extent the supplier seeks to recover the administrative costs for a dishonoured payment, in accordance with its contractual right to do so, payment of such amounts may form part of the consideration the customer provides for the supply of goods or services.

92. Services relating to the processing and administration of payments are not provided to customers independently or distinctly from the supply of goods or services provided by the supplier. Any costs invoiced or charged to customers for payment processing, including amounts for dishonoured payment, is not separate to the supply of goods or services provided to the customer, for which the customer's payment relates.⁸⁵

⁸⁴ See paragraph 103 of GSTR 2003/11. Also see paragraph 1.7 of the House of Representatives Supplementary Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill (No 2) 1999.

⁸⁵ See discussion of this issue by the Court of Justice of the European Union in *Everything Everywhere (formerly T-Mobile (UK) Ltd) v. Revenue and Customs Commissioners* [2011] STC 316.

93. The payment processing costs may form part of the consideration payable for the underlying supply.⁸⁶

94. Pursuant to this alternative view, the dishonour fee payment has the required nexus to the underlying supply, and is therefore consideration for the underlying supply.

Is there a change in consideration?

95. Where there is a nexus between the payment and the earlier supply, the payment may result in a change in the consideration provided for the earlier supply, which may result in an adjustment event under Division 19.

96. Alternatively, there may be no adjustment event under Division 19. The obligation to pay the dishonoured payment fee is, to the extent it forms part of the consideration, unknown until it is paid or payable. Although the effect is similar to an adjustment event under Division 19, by virtue of paragraph 29-25(2)(e) and paragraphs 92 to 97 of GSTR 2000/29, any GST will be attributable to the tax period that dishonour recovery amount is first known.

Part IV

97. Under this Part, we summarise the discussion in the paper, and note some points for your discussion on how the recovered dishonoured payment fees should be treated for GST purposes.

Summary

98. Payment of goods or services:

- a. Payment for a supply by way of cheque is conditional payment; payment becomes unconditional when payment is honoured.
- b. Payment for a supply by way of direct debit is contingent upon the supplier submitting a payment instruction that results in funds transferred from the customer's account.
- c. When payment by cheque or direct debit dishonours, it does not create a new debt as the debt owed for the earlier supply was never extinguished.
- d. A debt can be incurred but payable at a different time; deferment of a debt does not create a new debt but may result in credit being provided.
- e. Consent or intent of the parties is required for credit to be provided; the provision of credit may be implicit where a business relationship evidences payments made after the due date, or where goods or services are supplied on terms of trade that allows the customer time to pay.
- f. A subsequent payment may be attributable to an earlier supply if the circumstances indicate the required nexus between the earlier supply and later payment; where the required nexus exists an adjustment event (under the GST Act) may arise if the consideration has changed for the earlier supply.

99. Loss arising from a dishonoured payment for the supply:

- a. The loss arising from a dishonoured payment can be quantified upfront through a liquidated or agreed damages clause, or by agreement of the parties.
- b. Debts can be created or come into existence through contractual obligations.
- c. As a dishonoured payment does not change the debt owing for an underlying supply, the only transaction that may be subject to further GST treatment is the

⁸⁶ See *Waverley Council v. FC of T* [2009] ATC 10-095.

amount attributable to the recovered or on-charged dishonour fee and the payment of such amount.

100. A late payment is not the same as a dishonoured payment fee:

- a. A late payment fee may be imposed for a payment delay whereas a dishonour fee applies when payment is made but not honoured.
- b. A late payment fee is imposed directly on the customer by the supplier whereas the dishonour fee is imposed on the supplier by a financial institution before being passed on to the customer.
- c. The late payment fee represents the time delay cost of payment whereas the dishonour fee represents the cost of a dishonoured payment.
- d. A late payment fee may be imposed in addition to a dishonoured payment fee but a dishonoured payment fee cannot be imposed for late payment.

101. Recovering loss or damage from a dishonoured payment:

- a. Recovery or recoupment of dishonoured payment fees is akin to recovery of damages, provided the amount claimed is a genuine pre-estimate of the loss arising from the dishonoured payment.
- b. Parties can freely bargain and be bound by their contracts to pay liquidated damages, without interference of the courts, unless there is oppressive or unconscionable behaviour.
- c. Damages are meant to put the parties in the position they would have been had a breach not arisen or loss not been suffered.
- d. Penalties are not recoverable as damages.

102. Nexus between damages, supply and consideration:

- a. When damages are payable for a contractual breach, the payment may relate to a supply for the purposes of GST if the requirements of the GST Act and GST Regulations are met.
- b. The GST treatment of a damages payment will depend on what the damages are provided for; this is determined by considering the agreement and circumstances of that agreement rather than the words or titles given to particular obligations or rights under the agreement.
- c. Payment of the dishonoured payment fees may be for a separate supply if the circumstances show a separate supply is provided for that payment.

103. GST treatment:

- a. When dishonoured payment fees are recovered from customers, the GST treatment of such fees is not the same when the fees are passed on to the customer as when the fee is first incurred by the supplier.
- b. The GST treatment of a damages amount will depend on whether the payment is additional consideration for an earlier supply, or if the amount is consideration for a different supply, or if the payment is not for any supply.
- c. If damages are not provided for consideration and cannot be treated as a supply, payment of such damages is not within the scope of the GST regime.

Points for discussion

104. We seek your views on how recovered dishonoured fees should be treated for GST purposes. In particular we are interested in the following:

- 1 Apart from the situations identified above at paragraph 15, what other scenarios give rise to the supplier being able to recover dishonoured payments from their customers?
- 2 Do dishonoured payment fees arise if the dishonoured payment is made by way of direct debit authorisation on a credit card account?
- 3 Apart from what has been considered in this discussion paper, does any other possible GST treatment/s arise when dishonoured payment fees are recovered by a supplier following the dishonouring of a cheque or direct debit authorisation provided by the customer?
- 4 Can the recovered dishonoured payment fees be consideration for a financial supply, and if so, how does this arise?
- 5 Can the recovered dishonoured payment fees be consideration for a separate supply, and if so, how does this arise?
- 6 Is the expectation that the customer maintains sufficient funds or available credit to honour payment part of the mutual obligations and promises between the parties that does not give rise to a breach or damages?
- 7 Irrespective of whether the payment is consideration for a supply, will the amounts recovered for dishonoured payment fees always be characterised as damages? In other words, will the recovery of administration losses or costs, over and above the recovery of the dishonour fee charged by the supplier's financial institution, be regarded as damages?
- 8 If the recoverable dishonoured payment fees are characterised as damages, what are those damages provided for:
 - a. is it being provided for a breach of contract?
 - b. is it being provided as part of the underlying supply of goods or services?
 - c. is it being provided for no supply at all?
- 9 If dishonour fees recoverable for a breach of contract are part of the underlying supply, do all recoverable amounts receive the same GST treatment? For example, is the dishonour fee charged to the supplier by the financial institution treated the same as the other administrative losses or costs incurred by the supplier for the dishonoured payment?
- 10 If the payment is correctly characterised as damages for breach, is this a situation where the payment of damages is correctly characterised as not being consideration for a supply?
- 11 What administrative, accounting, system or contractual issues are likely to arise for business if any of the Alternative views discussed above were to become an ATO view on this issue?
- 12 Do any specific transitional issues need to be considered by the ATO in adopting a revised ATO view on this issue?

References

ATOlaw topic(s)	Goods and Services Tax ~~ Financial supplies ~~ payment instruments Goods and Services Tax ~~ General rules and concepts ~~ consideration
Subject references:	Goods and services tax GST consideration Cheques Direct debits
Legislative references:	ANTS(GST)A 1999 7-1(1) ANTS(GST)A 1999 9-5 ANTS(GST)A 1999 9-10

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	<p> <i>Herbert v. The King</i> (1941) 64 CLR 461; [1941] HCA 12 <i>HI Diagnostics Pty Ltd v. Psycadian Ltd</i> [2005] WASC 234 <i>Hussein v. Good</i> (1990) 8 ACLC 390 <i>John Graham Reprographics v. Steffens</i> (1987) 12 ACLR 779 <i>Lee Kong & Ors v. Pilkington (Australia) Limited</i> (1997) 25 ACSR 103 <i>Leigh-Mardon Pty Ltd v. Wawn</i> (1995) 13 ACLC 1244 <i>Marreco v. Richardson</i> [1908] 2 KB 584 <i>Molit (no. 55) Pty Ltd v. Lam Soon Australia Pty Ltd (Administrator appointed) & Anor (No. 2)</i> [1996] FCA 659 <i>National Australia Bank v. KDS Construction Services Pty Ltd</i> [1987] HCA 65; [1987] 163 CLR 668 <i>O'Dea v. Allstates Leasing System</i> (1983) 152 CLR 359 <i>Pioneer Concrete Pty Ltd v. Ellston</i> (1985) 10 ACLR 289 <i>Queensland Bacon Pty Ltd v. Rees</i> [1966] HCA 21; (1966) 115 CLR 266 <i>R v. Brown</i> (1989) 46 A Crim R 28 <i>R v. Page</i> [1971] 2 QB 330; [1971] 2 All ER 870 <i>Rema Industries and Services Pty Ltd v. Coad & Ors; Re Taspace Thermoforming Pty Ltd</i> [1992] FCA 114; (1992) 107 ALR 374 <i>Re Romer v. Haslam</i> [1893] 2 QB 286 <i>Richardson v. The Commercial Banking Co of Sydney Ltd</i> [1952] HCA 8; (1952) 85 CLR 110 <i>Ringrow Pty Ltd v. BP Australia Pty Limited</i> [2005] HCA 71; (2005) 224 CLR 656 <i>Russell Halpern Nominees Pty Ltd v. Martin & Anor</i> (1986) 4 ACLC 393; [1987] WAR 150 <i>Saffron v. Societe Miniere Cafrika</i> (1958) 100 CLR 231; [1958] HCA 50 <i>Shepherd v. ANZ Banking Group Ltd</i> [1996] NSWSC 115; (1996) 20 ACSR 81 <i>Standard Chartered Bank of Australia Limited v. Antico & Ors</i> (1993) 13 ACLC 1381 <i>Tallerman and Co. v. Nathans Merchandise</i> [1957] HCA 10; (1957) 98 CLR 93 <i>Taylor v. ANZ Banking Group</i> (1988) 13 ACLR 780 <i>Thomson v. Moyse</i> [1961] AC 967 <i>Tilley v. Official Receiver in Bankruptcy</i> [1960] HCA 86; (1960) 103 CLR 529 <i>TT Line Company Pty Ltd v. Commissioner of Taxation</i> [2009] FCAFC 178; (2009) 74 ATR 771; 2009 ATC 20-157 <i>Vidler v. FC of T</i> [2009] AATA 395; 2009 ATC 10-093; (2009) 72 ATR 832 <i>Waverley Council v. FC of T</i> [2009] AATA 442; (2009) 73 ATR 243; 2009 ATC 10-095 <i>Young v. Queensland Trustees Ltd</i> [1956] HCA 51; (1956) 99 CLR 560 <i>Zoverton v. Commissioner of Stamp Duties</i> (1988) 89 ATC 4339; 21 ATR 97 </p>
Other references:	<p> ATOID 2006/3 Australian Payments Clearing Association Limited Factsheet: Direct Facts on Direct Entry Australian Payments Clearing Association Limited Regulations for Bulk Electronic Clearing System Essential Services Commission of South Australia Energy Retail Code Essential Services Commission of Victoria Energy Retail Code GSTR 2000/19 GSTR 2000/29 GSTR 2001/4 GSTR 2001/6 GSTR 2002/2 GSTR 2003/11 GSTR 2006/9 GSTR 2009/3 Frequently Asked Questions and Answers 3.4 and 3.5 issued 25 September 2000 <i>Osborn's Concise Law Dictionary</i> Supplementary Explanatory Memorandum to the A New Tax System (Indirect Tax and Consequential Amendments) Bill (No 2) 1999. Tyree, A, <i>Banking Law in Australia (6th edition)</i>, LexisNexus Butterworths, Chatswood </p>
ATO references:	1-3VXNHWE

Appendix 1



GSTA TPP 065

Page status: **legally binding**

Page 1 of 1

Goods and Services Tax Advice

Goods and services tax: Is GST payable on a dishonoured cheque fee?**Preamble**

*This document is a ruling for the purposes of section 37 of the Taxation Administration Act 1953. It illustrates the principles contained in **Goods and Services Tax Ruling GSTR 2002/2 on financial supplies**. You can rely on the information presented in this document, which provides advice on the operation of the GST system.*

Answer

No, GST is not payable on a dishonoured cheque fee.

Explanation

A dishonoured cheque fee charged by an Australian authorised deposit taking institution (ADI) in the course of its banking business is input taxed under item 1 in the table in subregulation 40-5.09(3) of the A New Tax System (Goods and Services Tax) Regulations 1999 (GST Regulations).

Where a dishonoured cheque fee is on-charged by a supplier to its customer, the payment made in relation to the on-charge is consideration for the supply of an interest under item 2 in the table in subregulation 40-5.09(3) of the GST Regulations, to the extent that the customer has a contractual obligation (express or implied) to make good the loss (the dishonoured cheque fee) incurred by the supplier.

Such a transaction is a financial supply for the purposes of subsection 40-5(2) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), to the extent that the further requirements of subregulation 40-5.09(1) of the GST Regulations are met.

This analysis is not altered by the fact that the supplier increases the value of the on-charge over and above that which was originally levied on them.

Where no contractual obligation exists, the payment of the on-charged dishonoured cheque fee is a payment made for no supply.

Application of this GST Advice

This Advice is based on GSTR 2002/2. It explains our view of the law as it applied from 1 July 2000. You can rely on this Advice on and from its date of issue for the purposes of section 37 of the *Taxation Administration Act 1953*. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

If this Advice conflicts with a previous private ruling that you have obtained, this public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of this public ruling. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the date of issue of this later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

Commissioner of Taxation

Date

Subject references:

dishonoured cheque fee
on-charging

Legislative references:

ANTS(GST)A 1999 40-5(2)
ANTS(GST)R 1999 40-5.09
TAA 1953 37

ATO references

NO:	05/3095
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Appendix 2

Cheques Act 1986 (Cth)

Measure of damages on dishonour:

- (1) Subject to subsection (2), where a cheque is dishonoured, the holder may recover as damages from any person liable on the cheque, and an indorser who has been compelled to pay the cheque may recover as damages from the drawer or a prior indorser:
 - (a) if the cheque is dishonoured in Australia:
 - (i) the sum ordered to be paid by the cheque; and
 - (ii) the amount of any interest that, in accordance with the regulations, is payable in respect of that sum; and
 - (b) if the cheque is dishonoured outside Australia:
 - (i) the amount of the re-exchange of the cheque; and
 - (ii) the amount of any interest that, in accordance with the regulations, is payable in respect of that amount.
- (2) Where an action or proceeding is brought in a court for the recovery of damages under subsection (1), the court may, if it is of the opinion that justice so requires, direct that interest payable under that subsection be withheld in whole or in part.
- (3) Damages recoverable under subsection (1) shall be deemed to be liquidated damages.

Appendix 3

ATO views relevant to the issue

1. The current ATO view in GSTA TPP 065 states that when payment of on-charged dishonour fees occurs under a contractual obligation it is consideration for the supply of an interest under Item 2 in the table in subregulation 40-5.09(3) of the GST Regulations. The current ATO view indicates the transaction may be a financial supply. Where there is no contractual obligation, GSTA TPP 065 provides that any payment of the on-charged dishonour fee is made for no supply.
2. The view in GSTA TPP 065 arose from questions originally posed by Tax Practitioner Industry Partnership (TPIP) members about how dishonoured cheque fees were to be treated for GST purposes. The ATO responses published on the Banking and Finance⁸⁷ and TPIP⁸⁸ Issues Registers provided:
 - a. when a cheque is dishonoured, consideration for the supply has not changed nor has the supply been cancelled; the dishonouring of a cheque is not an adjustment event under Division 19 of the GST Act;⁸⁹
 - b. the levying of a dishonour cheque fee by an Australian authorised deposit taking institution (ADI) is consideration for a financial interest under Item 1 in the table to subregulation 40-5.09(3) of the GST Regulations;⁹⁰
 - c. the subsequent on-charge of a dishonoured cheque fee by a supplier to its customer (pursuant to a contractual obligation) was consideration for a financial interest under Item 2 in the table to subregulation 40-5.09(3) of the GST Regulations.⁹¹
3. Comments in paragraphs 62 to 71 of GSTR 2009/3 (relating to cancellation fees) provide a cancellation payment may be described as damages, a penalty or compensation but can still be consideration for a supply.
4. Paragraph 65 of GSTR 2009/3 (relating to cancellation fees) notes the fundamental question to answer is whether the amount (however described) is consideration for a supply for GST purposes.
5. GSTR 2001/4 (relating to court orders and settlements) establishes when a compensatory amount has the required nexus to be consideration for a supply.
6. Paragraphs 191 to 197 of GSTR 2002/2 (relating to financial supplies and related supplies) establish the GST treatment of recovery or on-charging of dishonour fees as a financial supply will depend on the capacity the taxpayer is acting; that is, as agent or principal.
7. Paragraphs 29 to 34 of GSTR 2000/19 (relating to adjustment events) confirm an additional charge for late payment (whether a fixed sum or calculated as a percentage) relating to supply can be described as damages or liquidated damages and is consideration for the supply of an interest in a credit arrangement.

⁸⁷ Frequently Asked Questions and Answers 3.4 and 3.5 issued 25 September 2000.

⁸⁸ Question 20.1 issued 06 April 2001.

⁸⁹ As confirmed at paragraphs 48-49 of GSTR 2000/19.

⁹⁰ That is made input taxed pursuant to subsection 40-5(1) of the GST Act where the further requirements of subregulation 40-5.09(1) are met.

⁹¹ That is made input taxed pursuant to subsection 40-5(1) of the GST Act where the further requirements of subregulation 40-5.09(1) are met. In cases where no contractual obligation exists, the payment of the on-charged dishonoured cheque fee is regarded to be a payment made for no supply.

8. Paragraphs 27 onwards in GSTR 2003/11 (relating to early termination of lease of goods) provide an early termination fee (where a party exercises a contractual or statutory right to terminate their lease) is a change in consideration for the earlier supply. This is in contrast to an early termination due to a default by a lessee which is discussed at paragraph 66 of GSTR 2003/11 where the lessee fails to properly perform its obligations and as a result the lessor terminates the underlying supply of the lease.
9. Paragraphs 71 to 75 of GSTR 2001/11 (relating to GST-free tertiary supplies) confirms that overdue charges and late payments are directly related to administrative services, and where those administrative services are provided by the supplier of a course they are GST free otherwise GST applies.
10. Paragraphs 72 to 77 of GSTR 2005/1 (relating to purchasing fuel with a fuel card) provide the fees applicable to a fuel card depend on the card usage. Fees may be applicable to input taxed supplies for any credit arrangement and may be applicable to taxable supplies for fuel acquisitions; apportionment of fees may be required.
11. Paragraphs 110 to 120 of GSTR 2006/2 (relating to security deposits) provide that the characterisation and treatment of a forfeited payment as liquidated damages is determined when it is initially paid. It is possible for a forfeited payment to be taken into account when determining the damages payable, without that forfeited payment being treated as damages; the forfeited payment is considered when calculating the compensable loss.
12. Paragraphs 88 to 91 of GSTR 2004/4 (relating to debt factoring) provide that where a separate fee is charged for debt collection services and sales accounting services under a debt factoring arrangement, that supply of services may be taxable and not input taxed. Items 13 and 14 of the table in subregulation 40-5.12 of the GST Regulations specifically exclude those services from being a financial supply.
13. Paragraphs 5 to 9 of GSTD 2000/10 (relating to outgoings payable by a tenant for a commercial property lease) provide the GST treatment of outgoings payable by the tenant will depend on how the outgoings are paid (as a direct cost or a reimbursement) and the agreement between the tenant and the landlord. Payment of outgoings by the tenant may form part of the consideration for the supply of the premises.
14. ATO ID 2008/116 states the payment of an additional amount for payment of Australian taxes, fees and charges by credit card is not consideration for a taxable supply, but is part of the underlying supply. This view was upheld in *Waverley Council v. FC of T* [2009] ATC 10-095.
15. GSTD 2006/3 (relating to settlement adjustments) confirms settlement adjustments for real property acquisitions are taken into account in determining the consideration for that supply or acquisition.
16. ATO Guidance: Issue 2.10 of the Property and Construction Industry Partnership – Issues Register – sec 02 – Building Contracts www.ato.gov.au. indicates that a when subcontractor who is in breach of a construction contract pays liquidated damages to the head contractor, the payment of liquidated damages by the subcontractor is not consideration for a taxable supply.

Appendix 4

Examples clauses for recovery of dishonoured payments

Each of the following clauses was been obtained from publicly available information where goods or services are being provided to customers. These are not considered to be exhaustive and are merely provided as illustrative for the purposes of this discussion paper.

Example 1

If you pay a bill by cheque and the cheque is dishonoured, you must also pay us a fee of \$15.00. If you pay a bill by direct debit and there are insufficient funds in the account, you must also pay us a fee of \$10.00. These fees do not attract GST.

Example 2

If there are insufficient clear funds in *your account* to meet a *debit payment*:

- (a) *you* may be charged a fee and/or interest by *your financial institution*;
- (b) *you* may also incur fees or charges imposed or incurred by *us*;

Example 3

Miscellaneous costs

We may charge You for the following things:

...

Dishonour fee (where Your cheque or direct debit payment is dishonoured)
\$22.00 per dishonoured payment

Example 4

What happens if You don't pay Your bills on time?

- (a) If You were not required to set up a Direct Debit when you commenced Your Plan and You do not pay Your bills on time for two months in a row, We may require You to provide Us with an authority to directly debit Your credit card or bank account with the amount of all future bills. If You need to cancel such a direct debit authority, We may ask You to provide an alternative means of payment.
- (b) You must pay Us any reasonable costs that We incur in pursuing the payment of amounts You owe Us, including any costs arising out of a failed direct debit authorisation, cheque or money order provided by You and any costs of any third party collection agency We may use and legal costs.

Example 5

Payment Dishonour Charges

- (a) If you elect to pay your bills by direct debit we may charge you a dishonour fee of \$22 if the payment is dishonoured by your nominated financial institution or credit provider.
- (b) We may also charge you a dishonour fee of \$22 if you pay us by cheque and the payment is dishonoured by your financial institution.

Example 6

If you choose to pay by direct debit and your financial institution fails to honour your payment, you must pay the amount owing directly to [supplier] and an additional administration fee may apply.

Example 7**Decline Fee**

We **do not currently charge customers a fee** if a direct debit payment is declined or a cheque is dishonoured. However, in future we reserve the right to pass on any such charges imposed by our bank. If we do introduce a Decline Fee, we will update our Pricing Schedule with the amount of the charge in accordance with clause 1.5(c) of the General Terms. Please refer to the most recent version of this Pricing Schedule, available on our website.

If you pay a bill:

- (a) by direct debit and there are insufficient funds in the account; or
- (b) by cheque and the cheque is dishonoured;

you may be required to pay an additional Decline Fee (as specified in the Pricing Schedule).

Example 8

We may not start legal action to collect money owing while *you* are making payments according to an agreed arrangement. In the case of dishonoured payment, we may recover the amount of the dishonoured or reversed payment, *plus* an extra fee from *you*.

Example 9

If:

- (a) you pay by cheque, direct debit or credit card; and
- (b) the payment is dishonoured or reversed by your bank; and
- (c) if you are a Small Residential Customer, the payment is dishonoured or reversed by your bank due to your fault,

you must pay us the Dishonoured Payment Fee.

Example 10**If your payment method fails**

If any payment method you use to pay us fails (for example a cheque or direct debit is dishonoured) then we may charge you a failed payment fee as set out in the Pricing Guide.

Example 11

If the withdrawal is declined by your bank or financial institution you are responsible for payment of any fees issued by your bank or financial institution. We will send you a notice requesting immediate payment and have the right to cancel this [direct debit request] agreement by providing written notice if a withdrawal is declined on two consecutive occasions. We may also charge you, and you will be liable for, any fees and charges incurred by us as a result of a withdrawal declined by your bank or financial institution, which will be detailed in a subsequent energy account.

Example 12***DRAWING ARRANGEMENTS***

The first drawing under this Direct Debit arrangement will occur on the evening of your first transaction following receipt of signed documentation. Funds will be debited through Westpac's Bulk Electronic Clearing System (BECS) from your nominated account. If any drawing falls due on a non-business day, it will be debited to your account on the next business day following the scheduled drawing date. If your drawing is returned or dishonoured by your financial institution, we will re-draw the following business day. After 3 failed attempts to obtain the payment, any further transactions with [supplier], will need to be paid by EFT/Debit Card or Credit Card, and any transaction fees payable by us in respect of the above will be added to your account.