



WEEKLY COMMENT: THURSDAY 5 FEBRUARY 2015

1. Continuing with GST, this week I look at 2 Questions We've Been Asked which were released late last year, and a third QB on a related subject released in June last year:
 - (a) Question We've Been Asked QB 14/13 *Goods and services tax – Lotteries, raffles, sweepstakes and prize competitions* was released by Inland Revenue on 12 December 2014 and replaces BR Pub 07/11 *GST – Lottery operators and promoters*, which expired on 21 December 2012 and QWBA *Cash prizes in sporting competitions – GST implications for organizing club* issued in May 2001; and
 - (b) Question We've Been Asked QB 14/14 *Goods and services tax – Late return charges (including library fines and parking overstay charges)* was released by Inland Revenue on 22 December 2014, and updates and replaces part of *Public Information Bulletin* No. 148, May 1986.
 - (c) Question We've Been Asked QB 14/06 *GST – Hire firm security bonds* was released by Inland Revenue on 27 June 2014 and is published in *Tax Information Bulletin* Vol. 26, No. 7, August 2014, page 131. It also updates and replaces part of *Public Information Bulletin* No. 148, May 1986.

Lotteries, raffles, sweepstakes and prize competitions

2. Question We've Been Asked QB 14/13 *Goods and services tax – Lotteries, raffles, sweepstakes and prize competitions* concerns the supply of services in the form of a lottery, raffle, sweepstake or prize competition, and incorporates legislative changes that apply from 17 July 2013, under which cash prize amounts are allowed to be deducted when calculating the consideration for the supply of prize competition services.
3. Section 5(10) of the *Goods and Services Tax Act 1985* ("the GST Act") provides that an amount of money paid by a person to participate in gambling (including a New Zealand lottery) or in a prize competition is treated as a payment for a supply of services by the following:
 - (a) For gambling, by the person, society, licensed promoter, or organiser who under the *Gambling Act 2003* conducts the gambling;
 - (b) For a prize competition, by the person who conducts the prize competition.
4. The important point is that it is not the prizes that are supplied, but the gambling services (in the case of a lottery, raffle or sweepstake) or the prize competition services (when conducting a prize competition). Therefore, the rules relating to the supply of the prizes are irrelevant. For example, s. 14(1)(b), under which the supply of donated goods or services by

a non-profit body is exempt from tax, will not apply to exempt the supply of prize competition services even if donated goods are used as prizes.

5. QB 14/13 contains a discussion of what constitutes “gambling” under the *Gambling Act 2003*. It is noted that definition of “gambling” in s. 4(1) of the *Gambling Act 2003* does not expressly include a lottery, raffle or sweepstake. However, the Commissioner considers that lotteries, raffles and sweepstakes fall within the definition of “gambling” and are therefore subject to s. 5(10)(a) of the GST Act.
6. Section 2(1) of the GST Act contains a new definition of “prize competition”. For GST purposes, “prize competition” includes competitions where the participant pays to enter and is competing for a cash prize and where the result is determined by the performance of participants of a particular kind of activity.
7. If the supplier of gambling services or a prize competition (as defined) is a GST registered person (which includes a person who is liable to be GST registered), they will need to account for GST for the supply of those services.
8. The supplier is the person or organisation conducting the gambling or the prize competition that people are paying to participate in. This is the person or organisation ultimately running the lottery, raffle, sweepstake or prize competition (i.e., the person or organisation on whose behalf the tickets are being sold). It is noted that in the case of state schools, often it will be the Board of Trustees. If they are GST-registered, they will need to account for GST on any lotteries, raffles, sweepstakes or prize competitions they conduct.
9. There are specific time of supply rules in s. 9(2)(e):
 - (a) For an amount of money paid to participate in gambling, the date on which the first drawing or determination of a result commences (except for an instant game played by a gaming machine, in which case the normal time of supply rules apply); and
 - (b) For an amount of money paid by a person to participate in a prize competition on the date on which the first drawing or determination of the prize competition commences.
10. Under s. 10(14)(a) and (b), the consideration for the supply of gambling or prize competition services is the amount paid by the participants in the gambling or prize competition, less any prizes paid and payable in money. It is only prizes in money that can be deducted. If the prizes in a lottery, raffle, sweepstake or prize competition are non-cash prizes, then the consideration for the supply is simply the amount paid by the participants to participate.
11. However, if non-cash prizes in a lottery, raffle, sweepstake or prize competition are purchased by the supplier, then an input tax deduction may be available for any GST component of the cost of those prizes. A non-profit body can claim input tax on goods or services acquired for other than making taxable supplies (but not exempt supplies) under s. 20(3K). If non-cash prizes are donated goods or services, then no input tax deduction can be claimed because no GST was paid for the prize.
12. It is noted that running a raffle, lottery, sweepstake or prize competition has a number of GST implications:
 - (a) There may be a requirement to register for GST if the value of supplies exceeds the \$60,000 threshold;

- (b) A GST-registered organisation's accounting system must be able to separate the GST from the takings for gambling and prize competitions that are covered by the rules (as opposed to other fundraising activities which may not be);
- (c) Input tax may be claimed on costs associated with running a raffle, lottery, sweepstake or prize competition;
- (d) There may potentially be tax invoicing requirements.

13. Three examples are provided which illustrate the facts that:

- (a) A GST-registered organisation must account for GST on prize competitions and gambling;
- (b) Only prizes in cash may be deducted from the consideration for the supply; and
- (c) Input tax may be deducted on non-cash prizes, providing they are not donated goods or services.

GST treatment of library fines and vehicle parking fines

14. Question We've Been Asked QB 14/14 *Goods and services tax – Late return charges (including library fines and parking overstay charges)* generally concludes that in most cases a late return charge will be subject to GST because the legal arrangements entered into between the parties will characterise the charge as additional consideration for the supply of a borrowed item.
15. Late return charges are distinguished from late payment charges. Late payment charges are amounts businesses charge for the late payment of an account. Under s. 5(25) and s. 5(26), a late payment charge will be subject to GST if the underlying supply to which that payment relates is subject to GST.
16. The Commissioner considers the law in this area to be well settled. The late return charge is either consideration for a supply or not. QB 14/14 refers to the discussion in QB 14/06 *GST – Hire firm security bonds*, which sets out the principles to be applied (see paragraph 19 onwards below).
17. It is noted that a 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:
- (a) The Commissioner considers that 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 and will be subject to GST. This view is supported by the decisions 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, a late return charge imposed for the late return of video films was held to be consideration for the supply of the borrowed item. This will be the case even if the original supply was for no consideration (a library book, for example).
 - (b) A charge imposed under a contract for breaching the terms of that contract, however, will not be subject to GST.

18. Four examples are provided. Examples 3 and 4, both of which deal with car parking, are meant to distinguish between additional charges for supplies and additional charges for a breach of contract. The distinguishing feature in the examples is the warning provided to users of the carparks:
- (a) In Example 3, a failure to display a valid unexpired ticket results in a charge of \$50 per day for parking: therefore, the \$50 is consideration for the supply of services; and
 - (b) In Example 4, the terms and conditions state that a failure to display a valid unexpired ticket will result in the issue of a parking violation notice requiring the payment of a \$100 fine, and the car may be towed: therefore, the \$100 is a payment for breaching the contract and is not a consideration for the supply of parking services.

Hire firm security bonds

19. Question We've Been Asked QB 14/06 *GST – Hire firm security bonds* concerns the GST treatment of a bond that is forfeited. The initial payment of the bond has no GST effect because there are no services supplied for the bond.
20. When a hire firm retains some, or all, of a bond, the GST answer will depend on whether there is a relevant supply and then on whether, or at what point, a payment is made for that identified supply:
- (a) If a bond is retained to pay additional hire charges when goods are returned late, that is consideration for a supply and GST will be payable. The supplier (the hire firm) must provide a debit note that meets the requirements of s. 25(3)(b), and make the relevant adjustment in the GST return for the period in which it became apparent that the output tax originally returned was incorrect.
 - (b) The same applies if the hire agreement provides that extra charges will be incurred and forfeited from the bond if the goods are used in a particular way.
 - (c) If a bond is retained to compensate for damage to hired goods, or because the hired goods are not returned at all, that is not consideration for a supply, but a payment of damages, and GST will not apply consistent with the Commissioner's view in *GST Treatment of Court Awards and Out of Court Settlements* published in *Tax Information Bulletin* Vol. 14, No. 10, October 2002, page 21.
 - (d) If the hire firm and the customer agree that the customer will buy the goods, GST will apply to that sale in the ordinary way with the hire firm issuing a tax invoice to the customer in the appropriate period.
21. Five examples are provided to illustrate the circumstances described above. Retention of part or all of the bond to compensate for repairs to damaged goods (example 2), goods not returned (example 3) and breach of hire conditions (example 5) is not consideration for a supply and no GST is payable. The application of the bond towards an additional hire period (example 1) or towards the purchase of the goods by the customer (example 4) will be consideration for a supply and GST will be payable.



Arun David, Director,
DavidCo Limited