

NO VAT ON FINES & PENALTIES: By Jonathan Hore

It often happens that contracts require performance of certain actions within some stipulated time or to some set standards. Where the time frames or standards are not met, this is usually met with a fine or penalty from the aggrieved party. This is also acceptable practice in construction contracts where contractors are penalised for delivering projects late. The aggrieved party charges a penalty as the delay may result in loss of business or some sort of inconvenience. The big question that usually arises in these circumstances is whether the injured party should charge VAT when raising the penalty or fine (hereinafter jointly referred to as 'penalty'). I will analyse this concept in detail in today's article. In this article, words importing the masculine shall be deemed to include the feminine.

WHEN VAT IS CHARGED

In general, VAT is charged when goods and services are supplied. Obviously, penalties do not fall under goods and we should consider them under services. The VAT Act stipulates that a 'service' is, 'anything done...' The above quote makes quite it clear that in order for us to talk about a service for VAT purposes, we should have someone who does something that should then be consumed by another. In other words, someone should do something which would make the other person want to pay for that thing. There is need for deliberate action being taken by the first party and the recipient should consume the service so provided. Technically, this could be in the form of someone offering training services and the customer getting trained consumes such service. The provider of the services would then, if registered for VAT, apply VAT on the training services. So, we may conclude that in order for a service to exist for VAT purposes, something must be done by the one claiming payment from the other party. Where nothing is done, there cannot be VAT on services, save in very rare and exceptional circumstances.

PENALTIES

Let's now use the above analogy to determine whether there is VAT on penalties levied for late or non-performance of certain activities. We noted above that for VAT to be levied, someone must have done something in respect of which they will get paid. In the case of penalties, the one who claims such amounts literally does nothing. In other words, they do not offer a service in respect of which the payer makes payment. The penalty is just a punishment for failure to meet a certain condition. Now that we have realised that there is an absence of, 'anything done' in such cases, we can comfortably state that penalties do not satisfy the definition of service, which requires that something be done. The recipient of penalties does nothing to earn the penalty, so there certainly can't be VAT on such amounts. The simple fact that someone is registered for VAT does not mean that they must always charge VAT whenever they make supplies. One needs to look at the service or good being supplied before levying VAT.

CONCLUSION

There is a certain clause in the VAT Act which stipulates that a supply includes, the act of 'tolerating any activity.' One may argue that the one who charges a fine or penalty would have tolerated an activity, being the delay in finalization of something agreed in time or any other such activity. On the other hand, one may counter argue that the one who levies the penalty cannot be said to have tolerated the delay as they certainly did not expect it to occur in the first place. As a result, the charging of the penalty would fall outside the ambit of Vatable transactions.

I must state that this is one of the issues that requires a guidance from BURS, just to ensure that there is uniformity in application by all taxpayers. It may not be surprising that some

taxpayers charge VAT on penalties whilst some do not. However, it is clear that interest is exempt from VAT and if a penalty takes the form of interest, then there is no need to worry about VAT.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.