

No VAT on penalties

In the world of finance, penalties are usually imposed on defaulters after failing to abide by the terms of a binding covenant. For instance, parties may enter into a hire purchase agreement whereby the purchaser is obliged to contribute monthly instalments till the full amount of the purchase price for the goods or service is paid up. Another agreement may stipulate that goods/services are provided on credit and the purchaser should settle his/her account with the seller after sixty days. In both instances, if the purchaser defaults or makes a late payment of the money due to the supplier, an additional fee may be charged on that late payment or default. The additional fee may be termed a finance cost, a fine, a surcharge, an interest or simply a penalty. For VAT registered persons, the receipt of the penalty levied in the course of trade usually poses a challenge on its treatment. Does the penalty charge attract VAT or not? Therefore, the purpose of today's article is to address the VAT treatment of surcharges levied on defaulters in the ordinary course of trade.

The VAT Act requires registered persons to charge VAT on the taxable supply of goods and services except for exempt supplies. Consequently, penalty charges are part of financial services which are exempt from VAT. Here is why? Fines are levied as a mechanism of managing the credit facility between the seller and the buyer and the VAT (Exemption) Regulations exempts financial services related to the management of credit and debts.

Thus, penalties are not chargeable to VAT as they form part of the exempt financial services. Hence, the receipt of these fines are exempt supplies. You can read more tax articles on our website, www.aupracontax.co.bw under the 'Tax Articles' tab. **This article is of a general nature and is not meant to address particular matters of any person. Please contact us on +267 71815836 +267 3939435 or jhore@aupracontax.co.bw for tax consulting or to join our free Tax WhatsApp group or to know about our 9 Tax e-books**