



GSTA TPP 017 - Goods and services tax: Does a credit card chargeback by a financial institution against a merchant give rise to an adjustment event for the merchant?

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 This document has changed over time. This is a consolidated version of the ruling which was published on *21 August 2013*



Goods and Services Tax Advice

Goods and services tax: does a credit card chargeback by a financial institution against a merchant give rise to an adjustment event for the merchant?

Preamble

*This document was published prior to 1 July 2010 and was a public ruling for the purposes of former section 37 of the **Taxation Administration Act 1953** and former section 105-60 of Schedule 1 to the **Taxation Administration Act 1953**.*

*From 1 July 2010, this document is taken to be a public ruling under Division 358 of Schedule 1 to the **Taxation Administration Act 1953**.*

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

[Note: *This is a consolidated version of this document. Refer to the Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.*]

Answer

No, generally a credit card chargeback by a financial institution against a merchant does not give rise to an adjustment event for the merchant in the circumstances outlined below.

However, an exception to the general rule above is where the chargeback is due to the fraudulent use of a credit card (eg a stolen card). In this case the chargeback may give rise to an adjustment event for the merchant under paragraph 19-10(1)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Some chargebacks (such as duplicated transactions and refunds posted as sales) may simply give rise to 'errors' in the GST reported in an earlier business activity statement (BAS). These can be 'corrected' by the merchant in a revised BAS¹ for the tax period in which the error occurred or in a later BAS provided the conditions in GSTE 2013/1 – *Goods and Services tax: Correcting GST errors Determination 2013* are met.

See 'Explanation' for the application of the ATO view to several specific chargeback circumstances.

Background

The expression 'chargeback' in this context means the reversal of a credit to the merchant.

A credit card chargeback may arise in various circumstances. Whether a chargeback by a financial institution against a merchant gives rise to an adjustment event for the merchant under the GST Act depends on the circumstances giving rise to the chargeback and the terms of the relevant agreements between customers and merchant and merchant and financial institution.

Some examples include a duplicate transaction, fraudulent use of a credit card, a missing imprint or missing signature, an invalid account number, or a refund posted as a sale. Other situations include where the merchant has failed to obtain the necessary authorisation for a manual or off-line transaction, or where the merchant fails to provide a copy of the authorisation details of a transaction.

¹ For tax periods that start on or after 1 July 2012 an assessment is made when the BAS is lodged. When entities lodge a revised BAS they are applying for an amendment.

Explanation

A credit card chargeback will not give rise to an adjustment event if the relevant contractual arrangements have the effect that:

- (a) the transaction between the merchant and the customer is complete at the time:
 - (i) when the customer produces the credit card and signs the authorisation slip when a payment is made in person; or
 - (ii) when the customer provides the card number and other required details when a payment is made remotely (for example, by phone or Internet); and
- (b) the effect of the production of the credit card in person or remotely is that the merchant has unconditionally accepted the card as consideration in full satisfaction of the supply of the goods or services; and
- (c) a term of the contractual arrangement between the merchant and a financial institution provides that as a result of a subsequent event the merchant does not receive payment as anticipated.

Note: The views in this Advice are based on the contractual arrangements between the parties having this effect. The GST consequences of a chargeback may be different if the relevant contractual arrangements do not operate in this way.

In the above circumstances, the merchant has unconditionally supplied the goods and services to the customer for the agreed consideration. The fact that the merchant did not subsequently receive a cash payment from the financial institution is a matter for the contractual arrangements between the merchant and the financial institution, and not the contractual arrangements between the merchant and its customer.

Therefore, a chargeback does not have the effect of changing the consideration for the supply by the merchant to the customer. It is not an adjustment event under paragraph 19-10 of the GST Act.

Under paragraph 19-10(1)(b) of the GST Act, an adjustment event is any event which has the effect of changing the consideration for a supply or acquisition. (A chargeback is not an adjustment event under paragraph 19-10(1)(a) of the GST Act 'cancelling a supply' or paragraph 19-10(1)(c) of the GST Act 'causing a supply to stop being a taxable supply'.)

Is there a change in the consideration for a supply to a customer that is the subject of a credit card chargeback?

The relationship between the customer, merchant and financial institution is normally governed by three separate bilateral contracts.

There is clear judicial authority (*Re Charge Card Services*⁵; *Diners Club*⁶) that the acceptance of a credit card by a merchant represents an unconditional payment by the customer. Accordingly, the customer's liability to the merchant is extinguished at the point the credit card is accepted. This is confirmed at paragraphs 30-31 in GSTR 2003/12: when consideration is provided and received for various payment instruments.

Credit card chargeback

When a payment is made by credit card in person, consideration is provided and received when the recipient of the supply signs the docket to authorise the transaction. When a payment is made remotely (e.g. by telephone or through the Internet), the consideration is provided and received when the cardholder gives the card number and other required details.

Under the usual arrangement for credit cards, once the cardholder signs the credit card voucher or provides the card number and other details, the liability to pay the supplier is unconditionally discharged.

The cases of *Charge Card Services* and *Diners Club* have established the legal principles governing the operation of credit cards. Browne-Wilkinson V.C. in *Charge Card Services* said at 774-775:

I would reach the conclusion that payment by credit card is normally taken to be an absolute, not a conditional, discharge of the buyer's liability and that the particular features of the present case support this conclusion.

In the case of credit card sales, the seller does not even know the address of the purchaser, which makes it hard to infer an intention that he will have the right of recourse against the purchaser.

The cardholder's obligations to the [merchant] were absolutely, not conditionally discharged by the [merchant] accepting the voucher signed by the cardholder.



It was part of the *ratio* in *Charge Card Services* that there was no general principle of law that a method of payment involving risk of non-payment by a third party creates a presumption that acceptance of that method constituted conditional payment only. In other words, just because the financial institution has the ability to charge back an amount under the merchant agreement does not mean that the payment by the customer under the contract for sale is conditional.

It is noted that the UK VAT Tribunal decision of *Thayers Ltd* applied the decision in *Charge Card Services* in a chargeback context. The Tribunal stated that the ability of the bank to charge back under its merchant agreement did not mean that the customer's debt to the merchant continued to exist.

Based on the above authority, payment by use of a credit card unconditionally discharges the customer from any liability owed to the merchant in respect of the transaction. For GST purposes, it is the presentation of the card details and or the signing of the authorisation by the customer that represents the consideration provided for the supply. Therefore, a subsequent chargeback by the financial institution cannot alter the consideration provided to the merchant for that supply.

Accordingly, there is no adjustment event under paragraph 19-10(1)(b) of the GST Act. An adjustment event under this provision is 'an event which has the effect of changing the consideration for a supply'. There is no change in the consideration for a supply to a customer that is the subject of a chargeback.

Is there a bad debt adjustment arising from a credit card chargeback?

Section 21-5 of the GST Act requires that in order for a decreasing adjustment to arise in respect of a bad debt you must 'write off as bad the whole or a part of the debt'. There must therefore be a debt in existence that is capable of being written off in order for this provision to have application. The customers have been unconditionally discharged from any liability owed towards the merchant because of their credit card use. There is thus no debt between the customer and the merchant and Division 21 of the GST Act cannot apply.

Application of the above view to specific chargeback circumstances

The application of the above principles to various chargeback circumstances are discussed below. The view expressed on each type of chargeback is subject to the particular terms of the agreement between the merchant and customer. Whether the customer's liability has in fact been unconditionally discharged upon acceptance of the credit card depends on the terms of that contract.

Based on the information provided by the industry, the ATO understands that the following circumstances give rise to a chargeback.

Non-receipt of requested item

The agreement between the merchant and the financial institution provides that the financial institution can request a copy of the authorisation details to support the validity of the transaction. If the merchant fails to provide the details within the required timeframe the financial institution has the right to make a chargeback.

The circumstance giving rise to the chargeback arises out of the merchant's failure to observe procedures imposed under its agreement with the financial institution. Subject to any contrary terms between the customer and merchant, the customer has done all the things necessary to be unconditionally discharged from his or her liability to the merchant (assuming the transaction was not fraudulent).

This type of chargeback therefore does not have the effect of changing the consideration in respect of the supply to the customer. Accordingly, there is no adjustment event for the merchant.

Duplicated transaction

A duplicate transaction may be processed where, for example, the merchant's employees erroneously believe that the first transaction was not completed, so a second transaction is performed. Where the second transaction cannot be substantiated by an authorisation slip, the financial institution will raise a chargeback.

We understand the duplicate transaction is never recorded in the merchant's accounting system as a sale.

As there is no GST payable to 'reverse' in respect of this transaction, there is no basis for any adjustment. If for some reason GST has been attributed on the duplicate transaction, it should be treated as any other 'error' and corrected in a revised BAS for that period or in a later BAS provided the conditions in GSTE 2013/1: *Correcting GST errors* are met.

Over the floor limit - no authorisation

The agreement between the financial institution and the merchant allows for a chargeback where the merchant has failed to obtain the necessary authorisation for a manual or off-line transaction.

The circumstance giving rise to this chargeback arises out of the merchant's failure to observe procedures imposed under its agreement with the financial institution and not out of the conduct of the customer.

We consider that the customer's liability is unconditionally discharged and that such an event does not cause a change in consideration for the supply by the merchant. There is no adjustment event for the merchant.

Invalid account number

This chargeback arises in respect of a 'key entered' transaction where the card number has been recorded incorrectly. It is impossible for the financial institution to recover the amount from the customer and thus a chargeback is raised against the merchant.

The circumstance giving rise to the chargeback arises out of the merchant's failure to observe procedures imposed under its agreement with the financial institution. The error does not result from any act or omission of the customer and therefore his or her liability to the merchant remains unconditionally discharged.

This chargeback does not have the effect of changing the consideration for the supply to the customer. There is no adjustment event for the merchant.

Refund posted as a sale

The customer may have returned goods to the store for a refund. If payment was made by credit card the refund must also be made by credit card. Instead of crediting the card, the transaction is erroneously processed as a purchase by the merchant's employees. Upon discovering the error, the customer receives a credit from the financial institution for twice the value of the original purchase (once to reverse the transaction and once to correct it). The financial institution raises a chargeback against the merchant for twice the value of the transaction.

The return of the goods by the customer and the first charged back amount represent the cancellation of the original supply. This is an adjustment event under paragraph 19-10(1)(a) of the GST Act. The merchant is entitled to a decreasing adjustment where the requirements of sections 19-40 and 19-55 of the GST Act are satisfied.

The second charged back amount is in respect of the refund that was incorrectly processed as a sale. If the merchant has attributed GST on this erroneous transaction, it should be treated as any other 'error' and corrected in a revised BAS for that period or in a later BAS provided the conditions in GSTE 2013/1: *Correcting GST errors* are met.

Fraudulent Transaction (eg use of a stolen card)

The financial institution is entitled to raise a chargeback where a credit card has been used fraudulently. The merchant's employees may not have taken due care when processing the transaction by either accepting a defaced card or not checking the signature or expiry date on the card.

The usual contractual analysis needs to be modified in this instance. The conventional analysis contemplates separate bilateral arrangements. In the case of a fraudulent transaction, the 'customer' is not a party to the normal consensual arrangement. Credit card fraud resulting in a chargeback can be distinguished from the other chargeback scenarios as there is no arrangement between the parties governing payment in place. This means the receipt of consideration has not been unconditionally discharged.



Accordingly, the effect of the fraudulent use of a credit card and the subsequent chargeback is that the supply to the customer is no longer for consideration. This is contrary to what the merchant had understood when the sale transaction was executed.

The chargeback therefore gives rise to an adjustment event under paragraph 19-10(1)(b) of the GST Act.

Missing signature

A chargeback arises where a voucher retrieved upon request of the financial institution is found not to have a customer signature.

The circumstance giving rise to the chargeback arises out of the merchant's failure to observe procedures imposed under its agreement with the financial institution. Assuming that the customer was ready, willing and able to sign the authorisation at the time of the sale, the error has not resulted from any act or omission by the customer. The customer's liability to the merchant is still unconditionally discharged.

Therefore, the merchant has received consideration for the supply to the customer in full. There is no adjustment event for the merchant.

Missing imprint

A financial institution may raise a chargeback in respect of a key imprinted transaction where it cannot recover the amount due to the imprint being defective or lost.

The circumstance giving rise to the chargeback arises out of the merchant's failure to observe procedures imposed under its agreement with the financial institution. The error has not resulted from any act or omission by the customer so his or her liability to the merchant is unconditionally discharged.

Therefore, the merchant has received consideration for the supply to the customer in full. There is no adjustment event for the merchant.

Application of this GST Advice

This Advice applies [to tax periods commencing] both before and after its date of issue. However, this Advice will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Advice (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

14 June 2005

Related Rulings/Determinations/GST Advice:

TR 2006/10; GSTR 2003/12

Previous Rulings/Determinations/GST Advice:

GSTR 2000/23 (Withdrawn)

Subject references:

credit card chargeback
adjustment event
consideration

Legislative references:

ANTS(GST)A 99 Div 21
ANTS(GST)A 99 19-10(1)(b)
TAA 1953 Sch 1 Div 358
GSTe 2013/1 – Goods and Services Tax: *Correcting GST errors Determination 2013*

Case references:

Re Charge Card Services Ltd [1988] 3 WLR 764
Customs and Excise Commissioners v Diners Club Ltd;
Customer Services Ltd (1989) 4 BVC 74

ATO references

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