# Management activities and the right to input tax deduction

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**Tax analysis: Frank Mitchell, barrister at Monckton Chambers, explains the recent case involving Norseman Gold Plc which dealt with the practical application of the right to input tax deduction in respect of management activities being carried out by holding companies.**

## Original news

*Norseman Gold plc v Revenue and Customs Commissioners* [2016] UKUT 69 (TCC), [2016] All ER (D) 94 (Feb)

*The Upper Tribunal (Tax and Chancery Chamber) (UT) dismissed the appeal by the taxpayer company against a decision of the First-tier Tribunal (Tax Chamber) (FTT) dismissing the taxpayer's claim for recovery of input tax on the basis that the supplies it had made to its subsidiaries had not been supplied for a consideration and were therefore not taxable supplies within the meaning of section 5 of the Value Added Tax Act 1994 and article 2(1) of Directive 2006/112/EC.*

## What was the factual background to this case?

This case is a recent decision of the UT dealing with the practical application of the right to input tax deduction in respect of management activities being carried out by holding companies.

Norseman Gold Plc is the ultimate holding company of a corporate group. It is a UK, AIM listed, company but all of its operating subsidiaries are gold mining companies in Australia. The FTT found that Norseman was actively engaged in the management of these subsidiaries.

Notwithstanding this conclusion, the FTT had held that Norseman was not entitled to deduct the input tax it incurred for the periods 10/07 to 01/09 because it did not in fact make any taxable supplies. This arose because Norseman had incurred VAT and had provided management services but it had not charged its subsidiaries for these services in the periods in question. The FTT found that, in the absence of consideration, no taxable supplies were made. That conclusion was, on the law, hardly surprising but what makes the case interesting is the UT's consideration of Norseman's intention to effect supplies in return for consideration.

Readers will all be familiar with C-268/83: *Rompelman-Van Deelen v Minister van Financiën*, C-37/95: *Belgium v Ghent Coal Terminal NV* [1998] STC 260 and C-110/94: *Inzo v Belgium State* [1996] STC 569 and *Norseman* was, in effect, arguing that because it had an intention to charge the subsidiaries for the management supplies it should be entitled to deduct the input tax incurred. The appellant argued that the only reason it failed to make any charges for management services was because the subsidiaries were all loss-making and it would have required Norseman to make loans to the subsidiaries to fund the payment of the management invoices. The FTT made one, critical finding of fact, which the appellant did not succeed in successfully challenging, namely that there was only a 'rather vague intention to levy an unspecified charge at some time in the future'. In the months after the periods for which the input tax had been denied, charges were made to the subsidiaries but it appears that these charges did not relate to the services provided in the periods under dispute but related exclusively to later periods.

## What did the UT decide?

The UT dismissed the appellant's attempts to challenge the FTT's findings of fact and this laid the ground for the UT to uphold the FTT's findings of law.

The FTT and the UT placed some emphasis on the C-246/08: *Commission v Finland* legal aid case in which the Court of Justice held that the activity being carried out by the legal aid board in Finland was not liable to VAT because the payments were levied by reference to what people could pay rather than in return for the services provided. This is, in essence, a *Tolsma* reciprocity point (C-16/93: *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* [1994] STC 509).

There does not, however, appear to be much consideration by the court of the interaction between the foregoing principle and that which says that supplies made at a loss are still taxable supplies. The case of Thomas Fuchs is referred to but

not, apparently, for the proposition that supplies made at a loss are nonetheless taxable supplies (C-219/12: *Finanzamt Freistadt Rohrbach Urfahr v Unabhängiger Finanzsenat Außenstelle Linz (in the presence of Fuchs)* [2014] STC 114).

There the taxpayer had solar panels attached to his house and he had contracted to sell his excess electricity back to the grid. Despite the fact that he never had any excess electricity to sell to the grid he was still held to be engaged in economic activity and to be entitled to deduct the input tax he incurred.

The Court of Justice held:

> 'It is clear both from the wording of Article 4(1) of the Sixth Directive and the case-law of the Court that, for a finding that the exploitation of tangible or intangible property is carried out for the purpose of obtaining income therefrom, it is irrelevant whether or not that exploitation is intended to make a profit'

It is, in my view, settled law that taxable supplies made at a loss are taxable supplies nonetheless. Accordingly, (leaving aside any challenge that might be made to the proper taxable amount of the supply for the purposes of the appellant's output tax liability) there was no requirement on the appellant to charge its subsidiaries on a cost plus basis or to charge its subsidiaries in such a way that it would ensure a profit for Norseman Gold plc. It was, subject to having the level of the consideration challenged for output tax purposes, free to charge its subsidiaries a nominal sum for the management services it provided. I must confess that I would have regarded this as a well-settled principle, in cases going back to C-288/94: *Argos Distributors Ltd v Customs and Excise Comrs* [1996] STC 1359, C-317/94: *Elida Gibbs Ltd v Customs and Excise Comrs* [1996] STC 1387 and C-102/86: *Apple and Pear Development Council v Customs and Excise Comrs* [1988] 2 All ER 922 we know that the consideration is the subjective value of the supply agreed by the parties.

According to the UT however, HMRC submitted that:

> 'The critical point arising from the case law is that for there to be a direct link between the services performed by Norseman and a payment made by one of its subsidiaries, the amount of the payment must be dependent upon the value of the service rendered and not on the circumstances of the subsidiary.'

I cannot see how this can possibly be correct. Were it correct, taxpayers all around the UK would have available to them the world's simplest VAT wheeze—rather than charging consideration by reference to the value of the service rendered, choose an arbitrary figure by reference to the circumstances of the purchaser and the transaction then falls outside of the scope of VAT.

In my view, HMRC's submission fails to appreciate the true nature of reciprocity. I can decide to make a supply of legal services to a plc for £5,000 and then the next day decide to supply those same services to a destitute mother of one for £5. Both are taxable transactions because we, the parties to those transactions, agree that the service I am to provide is in return for the sum which I am to be given. I can decide that I am going to charge people whose names start with the letter 'P' half what I charge everyone else. There is reciprocity in all of these transactions. In *Commission v Finland*, the point was not that the recipients of legal aid paid a price calculated according to their personal circumstances, but rather that the charges made were purely means tested under legislation and there was no evidence that what was paid had anything to do with what was done. It is not a question of how the price is calculated but rather whether there is a price agreed between the parties in return for the services to be provided.

Take Mr Tolsma. It is clear that if I give a busker £500 out of a gesture of goodwill there is no reciprocity. However, if I agree to give him £50 to come to my house and play music for my children then there is reciprocity. That reciprocity exists whether we agree that I will pay £50, £0.50 or £500. The price we agree can be arbitrary, can be calculated based upon my mood or can be a number plucked out of thin air—the question is whether Mr Tolsma agrees that he will perform his services in return for that sum.

Ultimately the UT held that the supplies were not made for consideration, but then states:

> 'Suppose that the evidence had established that, before any supplies at all had been made, Norseman had formed the clear intention to charge the full cost of the supplies to its subsidiaries. Clearly, Norseman would be an intending trader and the supplies, when actually made and paid for on that basis, would be taxable supplies. But suppose the actual supplies were made without payment, it being agreed at the time with the recipient of the supplies that they would be free of charge for some good reason. I do not consider that it could possibly be maintained that the actual supplies were made for consideration simply because there had, at an earlier stage, been an intention (not in fact implemented) to make the supplies for consideration.'

The foregoing cannot be doubted save to the extent that the UT implies that in order for the supply to be taxable it is necessary to charge the full cost of the supply. The UT brings this to its logical conclusion at para [126] and holds that had the subsidiaries agreed to pay Norseman £100 per annum in return for the services it is 'unlikely' to satisfy the requirements of EU law necessary to establish consideration. In my view, there can be no doubt but that if Norseman had agreed that the subsidiary would pay £100 for those supplies, they would then have been taxable. That £100 would have been the subjective value agreed between the parties and it is simply not relevant that the price agreed bears no relation to the value of the services provided.

However, ultimately, it was the following finding which was devastating for the appellant:

> 'There is nothing in the findings of the Judge or…in the evidence before him to suggest that there was ever any intention, once the supplies had been made in the relevant period without payment that they would later be paid for.'

If there was no evidence of any intention to levy a charge in return for the supplies made there can be no taxable supply. However, in my view, a proven intention to charge an unspecified sum at a future point may well be sufficient to generate the right to deduction. The UT appears to have concluded otherwise because of its belief that an arbitrary or derisory consideration is not sufficient to fulfil the requirement that a supply must be made 'for consideration' in order to be taxable. I respectfully disagree with the UT's conclusion on that issue. In my view, if the appellant could have established that each subsidiary would pay what it could afford at the end of the year in return for the services those payments amount to consideration. However, it seems as though the findings of fact by the FTT did not go even that far, instead finding that there was only a vague intention to pay something. I agree with the UT that in light of such a finding of fact it is difficult to identify the necessary degree of reciprocity. Not because the consideration agreed was derisory but because no consideration was agreed.

## How does this fit with existing (UK and EU) case law on VAT recovery by holding companies?

This case is actually more about reciprocity than it is about VAT recovery by holding companies. All parties to the appeal, including the UT, appeared in agreement that if the appellant had been able to demonstrate an intention to make taxable supplies of management services it would have been entitled to deduct the input tax charged. The difficulty was that the FTT made findings of fact which tended to indicate that the appellant had not established an intention to make any charge (or, at least, any particular charge) as consideration for the supplies it had made. In the absence of any charge being agreed, there was held to be no consideration and therefore no taxable supplies of management services and, therefore, no right to deduction. This case does not in any way affect the position that companies which do provide management services to their subsidiaries in return for payment are entitled to deduction in respect of VAT incurred on acquisition costs or the provision of those management services. It does, however, underline the importance of agreeing appropriate charging structures for the provision of those management services.

## Does the decision provide any lessons for UK holding companies?

Implementation. Implementation. Implementation. I am sure we have all lost count of the number of times that perfectly sound advice was scuppered for the want of an invoice. Had payments been made by the subsidiaries expressly in return for the services to be supplied (whatever the level of those payments), taxable supplies would have been made and the input tax would have been deductible. Clients need to be consistently reminded of the need to implement the advice they are given and they need to put in place measures to ensure that implementation occurs long after the VAT advisors have disappeared and the company is dealing with the many other challenges of running its business.

*Interviewed by Alex Heshmaty.*

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