

## A category error

*Les Howard highlights a tribunal case concerning a holding company and input tax*

There have been a number of Tax Tribunal and Higher Court cases over the years involving holding companies. HMRC often try to argue that, since a holding company's activities are essentially passive investment, they are not 'making taxable supplies' nor are involved in 'economic activities,' thus denying input tax recovery. This was precisely the argument HMRC brought in the FTT case of Bluejay Mining PLC. HMRC denied over £800,000 of input tax over a period of seven-and-a-half years.

Bluejay is a UK-based mining company. Its mining interests were subsidiary companies in Australia, Finland, and Greenland during the periods in question. In each case, Bluejay provided a loan of €10m to the local subsidiary company and also delivered a range of technical and support services, for which it made a charge to the subsidiary. Para 23 of the decision refers to "services consisting of advisory, consulting, marketing, accounting, financial services and technological support and development services and any services necessary for the successful delivery of a mineral resource by the subsidiary."

Bluejay's Accounts indicated that the loans were repayable "when sufficient cash resources are available in the subsidiaries" and also that the invoices may not be paid for a number of months or even years. This is understandable given the sector Bluejay is involved in, as surpluses may take many years before being available to reimburse to the parent company. As a result of HMRC intervention in 2017, Bluejay changed this arrangement, so that it loaned money to the subsidiaries to enable them to pay invoices for support and technical services.

The key issue I want to highlight is in paras 32-33.

"In essence, HMRC's arguments for disallowing the input tax are:

(1) Bluejay's central activity is to make a return through investing by buying shares in foreign mining companies. It also supplies technical services to its foreign subsidiaries. In reality whether any payment is made by these subsidiaries to Bluejay is inextricably linked to their success or failure.

(2) In order to be able to claim input tax in relation to supplies of the services to the subsidiaries, Bluejay needs to be able to show that those services are supplied in return for a consideration. It also needs to show that those services are provided for the purpose of generating income on a continuing basis from the provision of those services; namely, that it is carrying on an economic activity.

(3) Because the invoices for the services are payable if and only if Bluejay's equity investment in the subsidiaries is commercially successful in one form or another, the future payments Bluejay points to as a price are not a genuine agreed price in return for the services. They are really just part of the overall return Bluejay obtains from its equity investment in the subsidiaries if they are successful.

(4) In addition, the role of the services is not to generate income on a continuing basis for Bluejay from payments provided in return for the provision of those services.

These arguments involve a significant recharacterization of the contracts between Bluejay and its subsidiaries. In particular HMRC is arguing that:

(1) The contract for services and the loan agreement should be considered as a single agreement which effectively provides that the payments for invoices will only be made if and only if the project is successful, and

(2) The purpose of the provision of the services is not to generate income on a continuing basis but is to enhance the value of its investment in the subsidiary, and, as such, does not amount to an economic activity.”

This section of the decision explains HMRC’s argument that Bluejay was simply seeking to secure the return of its investment in its subsidiaries. The support and technical services were not part of the generation of income on a continuing basis but an element of the loan agreement and therefore merely served to enhance the value of its investment in the subsidiaries. The Tribunal baldly stated that thereby HMRC sought to make “a significant recategorization of the contracts”. The contracts described the delivery of a range of support and technical services. But HMRC said those contracts should not be considered at face value but as part of the wider inter-company arrangement.

The latter half of the decision contains the Tribunal’s analysis of the contractual position, to address HMRC’s arguments. Although HMRC did not argue that the contracts were artificial, it is clear that HMRC were arguing that they did not reflect the ‘economic and commercial reality.’ The Tribunal concluded, quite quickly I think, that the contracts did reflect the economic and commercial reality. The apparently relaxed arrangement for repayment did not displace that reality.

The Tribunal also looked at a series of precedent cases concerning the issue of ‘contingent payment’. At first reading, these might have pointed in support of HMRC’s argument. I suspect Counsel for HMRC brought these cases with just such an expectation! This section (paras 43-57) seems to make a distinction between a case where the holding company has ‘a vague intention’ to expect payment and a case where it has ‘a very specific intention that the payment should be made’. It is the contracts and the wider inter-company arrangements which, on analysis, pointed towards the second option. In conclusion, Bluejay was providing services for consideration.

The final section follows inevitably. Bluejay was involved in an economic activity, seeking to obtain income on a continuing basis (PVD, art 9). Input tax was thus deductible.

In full expectation of the decision being appealed, Judge Gillett set out his conclusions in para 70. As it has transpired, an Appeal to the Upper Tier is on its way.

### **Comment – HMRC approach**

The way HMRC sought to re-categorise the contracts is a cause for concern. Doubtless Bluejay had contracts properly drafted, to protect its investment and to clarify the obligations and responsibilities of parent and subsidiary companies. Where HMRC seek to re-categorise, that leaves the Directors in a position of uncertainty as to the way HMRC will view the supplies it makes, and the VAT consequences of those supplies.

This approach is not limited to large companies. I have seen a similar approach in the SME and charitable sectors. HMRC give more weight to, for example, a website than to formal

contracts, thereby re-categorising the supplies made. Sport Academies Ltd is one such example.

**Comment: representation**

Such a case demands 'proper' legal representation with good tax counsel. I identified three reasons for this:

- There were over 2,500 pages of evidence in an electronic bundle. It is essential that Tribunal is guided through such material, with key documents highlighted.
- The taxpayer's business model, including inter-company contracts, needed to be well understood and well explained.
- And, of course, the ability to draw support from case law. There were nearly 900 pages of case law to trawl through.

Not a job for your 'common or garden' VAT consultant!

The Bluejay Mining PLC decision is here: <https://tinyurl.com/8cw8efe2>

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