2.4 Consideration

2.4.1 Introduction

The question of "consideration" is, clearly, absolutely central to the applicability of VAT to a given transaction. Under VATA 1994, s. 5(2)(a), a "supply" explicitly excludes "anything done otherwise than for a consideration".

This clear statement of principle covers virtually all commercial activity in practice. However, there are several exceptions to this rule, of which deemed supplies and self-supplies, covered at **2.7**, are perhaps the most important.

Unsurprisingly, the definition of consideration has been the subject of extensive case law. The topic is covered here as follows:

- an examination of the general principles (at **2.4.2**);
- some of the more common examples of what will not constitute consideration (see **2.4.3**);
- a brief summary of where consideration does not matter (see **2.4.4**);
- grants (see **2.3.5** above); and
- subsidies (see **2.4.5**).

The rationale for handling them in this way is provided in the relevant part of the text.

The reason for focus on these areas is that the question of consideration comes up most acutely and frequently in this context.

In most cases, whether or not a payment is consideration will not be a concern. The answer will usually be clear, as the examples at **2.4.3** demonstrate.

Nevertheless, owing to its importance to the VAT system, if the question of consideration does arise, it is likely to have wide-ranging effects on both output VAT liability and the recoverability of input tax. Moreover, as stated at **2.2.2** and **2.3.5** above, the circularity of determining whether or not an activity or income stream amounts to "business" or "consideration" or both, and therefore whether a supply exists at all, can lead to very complex technical points.

Law: VATA 1994, s. 5(2)

2.4.2 General principles

Definition

The statutes at both EU and UK level do not define consideration *per se* for VAT purposes.

However, an excellent starting point is found at archived PVD, art. 73, which defines the "taxable amount" (i.e. the amount potentially subject to VAT) as:

> "everything which constitutes consideration which has been or is to be obtained by the supplier in return for the supply from, the customer or a third party."

The reference to a third party is highly significant, and is the concept by which subsidies are brought within the VAT net (see **2.4.5**); it can also lead to very unwelcome input VAT outcomes, as outlined in **2.10.4** (see the discussion of the cases of *Redrow* and *Airtours*).

With a bit of imagination, it is clear that the phrase "*everything*… obtained by the supplier in return for the supply" [*emphasis added*] opens up the way for barter transactions. In other words, consideration can also be non-monetary.

It also means that a situation where two parties swap goods or services is also (at least potentially) open to being regarded as a supply, since the items swapped could amount to something obtained in return for a supply.

HMRC guidance

HMRC's *VAT Supply and Consideration Manual* at VATSC 05100 offers a very useful introduction to the subject and, with limited additional commentary, will serve to provide a good overview of the key points of principle.

HMRC provide the following comments on the legal definition:

> "There is no definition of consideration in the VAT Act 1994. Neither is it defined in the EU Principal VAT Directive. In the UK, the meaning was originally taken from contract law, but after the European Court of Justice (ECJ) confirmed that the term is to be given the Community meaning and is not to be variously interpreted by Member States the UK adopted that approach. The Community definition used in ECJ cases is taken from the EC 2nd

VAT Directive Annex A13 as follows even though this Directive is no longer in force:

> 'The expression "consideration" means everything received in return for the supply of goods or the provision of services, including incidental expenses (packing, transport, insurance etc), that is to say not only the cash amounts charged but also, for example, the value of the goods received in exchange or, in the case of goods or services supplied by order of a public authority, the amount of the compensation received.' "

The quotation from archived PVD, art. 73, set out above, is essentially derived from this older EU definition.

HMRC then go on to explain how this definition is interpreted:

> "The phrase in return for the supply is interpreted to mean that there *must be a direct link* between the supply and the consideration.
>
> Therefore in order that a supply for a consideration can be made, there must be *at least two parties* and a *written or oral agreement between them* under which something is done or supplied for the consideration. There is a direct link between the supply and the consideration because *the supplier expects something in return for his supply* and *would not fulfil his obligation unless he thought* that payment would be forthcoming." [*emphasis added*]

This is about as clear a summary of the law as could be provided.

The manual also includes some additional comments that help to clarify the boundaries of this concept. First, it is clear, as noted above, that *non-monetary* items can amount to consideration:

> "Consideration is a payment for the supply of goods or services. It is usually a payment in money, but can also be of a "non-monetary" nature, such as goods or services supplied in return."

Secondly, a helpful point is made with regard to the question of profit, which is often (perhaps understandably) confused with consideration:

> "Consideration should not be confused with profit. Whether a payment yields profit or loss is immaterial and has no bearing on whether or not it is consideration. This was brought out in Heart of Variety (LON/75/15) where the tribunal said that:

> 'the concept of consideration and profit are wholly different, and the fact that a trader makes no profit on a supply does not, in our view, mean that there is no consideration for it.' "

HMRC then do much of the hard work in terms of reviewing the crucial case law in this area, with four European cases that examined the "direct link" point covered in reasonable detail. Some additional comments are added for clarity's sake, as needed. Each case is examined in turn.

Case: *Heart of Variety* LON/75/15

The Dutch potato case

The first case is the so-called *Dutch potato* case, which HMRC discuss as follows:

> "The case of Staatssecretaries van Financien v Cooperatieve Aardapplenbewarr-plaats ((1981) ECR 445; (1981) 2 cmlr 337) involved a co-operative providing cold storage facilities to its members who had the right to store potatoes because of the share each member held in the co-operative. Charges were normally made to the members for the storage but for two consecutive years no charges were made. This resulted in a drop in the value of the shares (reflecting the co-operative's reduced profits because of the lack of storage fee income). The Dutch tax authorities argued that the reduction in value of each members share was effectively consideration for the storage which had been provided for no fee. The ECJ rejected this argument. There was no direct link between the services of storage and the decrease in share values. Additionally the reduction in value of the shares could not be equated directly to the cost or any other measure of the value of the services provided."

This is plainly an unusual case that is very fact specific. Nevertheless, it does provide an important outline of the key point: it is not enough that the financial position of one party *vis-à-vis* another party has changed; there must be a direct link between what is provided and the financial position for it to amount to consideration for a supply. This in turn will often mean that there is therefore no supply.

Case: *Staatssecretaries van Financien v Cooperatieve Aardapplenbewarr-plaats* (1981) ECR 445; (1981) 2 CMLR 337

Guidance: VATSC 05100

BAZ Bausystem GmbH

The next case is *BAZ Bausystem GmbH*, which HMRC discuss as follows:

> "Here the ECJ held that interest awarded to an undertaking by a judicial decision was not consideration where the reason for the award was that the balance of the consideration for services was not paid by the due date, because it had no connection with the services provided and did not constitute consideration relating to a commercial transaction – it was simply compensation for the delay in payment."

In other words, late payment interest is not subject to VAT, because it is not consideration for the supply. This case also has relevance to the comments on fines and penalties in **2.4.3** below, though as it is now 40 years old, it is likely that more recent case law will be more useful.

Case: *BAZ Bausystem Gmbh v Finanzamt Munchen Fur Korperschaften* C-222/81
Guidance: VATSC 05100

Apple and Pear Development Council

The third case is a UK case, relating to the Apple and Pear Development Council (APDC), a now-defunct body that was intended to manage and promote apple and pear growing in the UK. HMRC comment as follows:

> "The Council is a statutory body formed to promote the sale of apples and pears. Commercial growers were required to register with the council and pay an annual levy. The industry as a whole received the benefit of its promotional activities. The point at question was whether the levy was consideration for the promotional activities. The European Court held that there was no direct link between the supply made and the "payment" received, that is benefit, was not directly related to payments made, and individual growers were obliged to pay the levy, regardless of whether they benefited.
>
> The points which demonstrated this were:
>
> - The benefits of APDC's services accrued to the whole industry, individual growers deriving benefits indirectly from those accruing to the industry as a whole.
> - There was no relationship between the level of benefits individual growers obtained and the amount of charges they were obliged to pay.

- The charges were always recoverable from each grower as a debt due to APDC, regardless of whether or not a given service conferred a benefit to them."

The principles listed here are important, and it is clear that a lump sum payment that bears no real relation to the "supply" being made will almost certainly not be regarded as consideration. Note, however, the case of *Le Rayon d'Or SARL*, discussed at **2.4.5** below, which may sit at odds with this.

Case: *Apple and Pear Development Council* C-102/86
Guidance: VATSC 05100

Tolsma

The fourth case is that of *Tolsma*. HMRC's comments at VATSC 05100 are limited:

> "Another ECJ case, Tolsma … , confirmed that for us to see a supply there should also be 'reciprocal performance'."

Fuller HMRC discussion of the case may be found at VATSC 06110:

> "Mr Tolsma played a barrel organ on a public highway and invited passers by to leave donations. The Dutch authorities assessed for output tax on these payments since a supply had been made to the passers by.
>
> The ECJ accepted Mr Tolsma's appeal and ruled that the playing of music on the public highway for which no payment was stipulated did not constitute a supply of services effected for consideration and so it was not within the scope of VAT. This was because there was no agreement between the parties, and there was also no necessary link between the musical service and the payments to which it gives rise. Mr Tolsma played whether the passers by paid him or not and he had not entered into a formal agreement with them for the provision of his services."

In other words, the behaviour of the "supplier" is important. If he or she will continue to "make supplies" regardless of whether money is received, then those monies will not amount to consideration. This has relevance for donations to charities, etc., provided these are wholly voluntary on the part of the donor.

Case: *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* C-16/93
Guidance: VATSC 05100, 06110

Other points

HMRC round out their commentary towards the end of VATSC 05100, as follows:

> "Other points on consideration which can be drawn from these cases are:
>
> - Consideration is to be defined widely to bring within the tax *everything which the taxable person receives* as consideration for the goods or services supplied.
> - The consideration must be *capable* of being expressed in money.
>
> In some circumstances a person may pay for a supply to be made to someone else, for example, where a holding company pays for items such as fuel and electricity which are supplied to its associated companies. As long as there is an agreement between the supplier and the recipient there is still a direct link between the supply and the consideration. *However, the supply is to the recipient, not to the payer*." [*emphasis added*]

The final point, which essentially describes third party consideration, is hugely important in terms of the recovery of input VAT.

Guidance: VATSC 05100

Summary

Overall, the principles set out above are fairly clear in practice and the vast majority of normal business activities will have easily identifiable consideration.

However, difficulties will arise usually in two areas:

- where the monies are unusual in form, e.g. subsidies, penalties or some other kind of income other than normal payment for a supply; and
- where the link between the monies received and the activities in question is not entirely clear.

The first bullet point will tend to attract attention from HMRC from an output VAT perspective, while the latter will tend to lead to queries under an input VAT heading. Even so, each has impacts on the other.

The examples at **2.4.3** below and the discussion of subsidies at **2.4.5** will help to illustrate the issues that can arise.

2.4.3 Examples of what will not constitute consideration

Overview

This section gives specific and common examples of things that will not be regarded as consideration, based on the general principles outlined at **2.4.2**. A number of the examples are then briefly discussed further.

The following is a non-exhaustive list:

- tips and other freely given monies, e.g. to buskers, as in *Tolsma* (see **2.4.2**);
- voluntary donations;
- loans (see below);
- dividends;
- the issue of shares by a company (see *Kretztechnik AG*);
- cash distributions on a winding-up of a company;
- partnership profit shares;
- the entry of a new partner into a firm for a cash capital introduction (see *KapHag*);
- disbursements (as properly understood – see below);
- security deposits (see below);
- payments under an insurance claim;
- dilapidations (see **Chapter 3**);
- fines and penalties (see below); and
- prize money, for example for winning a sporting competition.

These should all be understood to be in the form of money. Non-money transactions – for example, a dividend of a property *in specie* from a company to a shareholder – will almost always be regarded as a supply by virtue of the deeming provisions, as explained at **2.7**.

Some of these items require further discussion; some are so complex as to require detail far beyond the scope of this book. As a rule of thumb, if one party does not provide something in return for a payment, then it is likely that it will not be consideration. This is, though, subject to the deemed supply rules, as set out at **2.7**.

Cases: *KapHag Renditefonds v Finanzamt Charlottenburg* C-442/01; *Kretztechnik AG v Finanzamt Linz* C-465/03

Loans

A taxpayer receiving monies by way of a loan will not be in receipt of consideration. This principle is clear and can be valuable in the context of connected parties and supplies of services, especially continuous supplies (see **2.6.7**).

Unsurprisingly, simple payments into a bank account, where it is not entirely clear that one party is not doing something for the other, will be more difficult to describe as a loan in the absence of a written agreement.

This issue is well discussed in VATTOS 5165 in the context of the tribunal's decision in *Mercantile Contracts Ltd*:

> "The Tribunal accepted the claim that these payments were made under a separate loan agreement and thus did not create tax points for the supply of building services.
>
> Similar claims should therefore not be dismissed lightly. Nevertheless, the tax payer must provide evidence to substantiate the existence of a loan agreement. Although this might not amount to a written agreement, it is not unreasonable to expect existence of the loan to be supported by correspondence, minutes of board meetings, or other contemporary records. In the absence of satisfactory evidence you may normally take the view that the amounts represent payment for the supply."

Case: *Mercantile Contracts Ltd* (VTD 4357)
Guidance: VATTOS 5165