

VATR 32 (Govt Gazette No. 54 of 05 June 2010)

Facts

A Ltd is engaged in the provision of management services, including financial and human resource services to related companies. B Ltd which operates a Hotel is a related company in which A Ltd holds shares, representing 23% of the total shares. A Ltd derives management fee from B Ltd as a consideration for the service it provides to this company under a management agreement. There is, however, no formal written management agreement between the two companies.

Pursuant to a restructuring exercise, the management agreement between the two companies has terminated and consequently B Ltd has to compensate A Ltd. The compensation has been computed at some Rs 203 million and is based on an independent valuation. The consideration for the compensation will be by way of shares, so that B Ltd will issue new shares to A Ltd.

Points in issue

Confirmation that-

- a) the compensation receivable by A Ltd is outside the scope of the VAT Act, as it is not a consideration for a supply of services but instead a receipt of capital nature, being compensation for the loss it will suffer subsequent to the termination of the management contract.
- b) A Ltd would not be required to disclose the transaction in its VAT return as it is not a supply and is neither a zero-rated supply nor an exempt supply.
- c) Since A Ltd would not charge VAT on the compensation payment, the question of input tax does not arise.

Ruling

On the basis of the fact that the compensation is not provided in any written contract between A Ltd and B Ltd, the amount receivable by A Ltd is a consideration for the surrender of a right and therefore constitutes a supply in accordance with the provisions of Section 4 (2) (b) of the VAT Act.

The issues raised in the circumstance do not arise and A Ltd will therefore be required to disclose the transaction in its VAT return and also charge VAT at the appropriate rate in that respect.