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Global Tax Update

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1. VAT on selling expenses participation deductible

Selling a participation usually involves a lot of costs. The VAT on these costs is not always deductible, not even for parties engaged in VAT-taxed supplies. This is likewise shown in a recent judgment by the Den Bosch Court of Appeal.

(1) The proceedings before the Den Bosch Court of Appeal

In the proceedings before the Den Bosch Court of Appeal the taxable person was a holding company engaged in paid management activities. Those management activities were supplied to a company whose shares were held by an intermediate holding company in which the interested party held one third of the shares. The intermediate holding company sold the shares it held in that company in 1998. Hence, the management activities by the related taxable person were terminated. The related taxable person had incurred costs when selling this company. It did not charge these costs, involving advisory services, to the intermediate holding company. The dispute in the proceedings is about whether the taxable person may deduct the VAT on these selling expenses.

(2) Judgment of Den Bosch Court of Appeal

According to the Den Bosch Court of Appeal, as regards the advisory services the related taxable person must be regarded as the customer. The invoices for the related costs were addressed to the taxable person, which paid for them. The most obvious action, however, would have been for the taxable person to charge these costs to the intermediate holding company. Since it did not do so, the taxable person has no taxed income directly related to the sale to offset the selling expenses. Hence, according to the Court of Appeal the taxable person may not deduct the VAT on the selling expenses.

Even if the taxable person had rightfully borne the costs itself – and thus had rightfully not charged them to the intermediate holding company – the Court of Appeal still takes the position that there is no entitlement to deduct input tax. This is because the costs relate to an exempted sale of shares. According to the Court of Appeal the outcome could have been different if the selling expenses had constituted general costs that would not have been included in the selling price of the shares. In that case the costs as such would have had to be related to the business of the taxable person. Likewise, they would have had to be included in the taxable person’s VAT-taxed income. Although the taxable person had linked the costs and the output, it had not provided a sufficient substantiation. It had failed to prove that engaging the advisor was within the scope of its VAT-taxed management activities. No management contract had been submitted showing that the support with selling the shares was part of its activities. According to the Court of Appeal the position is implausible, too, because a management payment of NLG 66,667 was received in the year 1998, while the costs amounted to NLG 241,996 including VAT. What's more, the costs were non-recurrent costs and did not form part of the operating expenses of the interested party's company. Hence, according to the Court of Appeal it is unlikely for the costs to have been included in the regular VAT-taxed sales. Finally, the taxable person's attempts to undertake new management activities (this did not succeed until 2003) were to no avail. According to the Court of Appeal there is no indication of a connection between these new activities and the selling expenses.

(3) An unconvincing justification

While the consequences of the Court of Appeal's judgment – there is no deduction of VAT on the selling expenses – are clear, in our opinion the judgment is highly debatable. One rather peculiar point regards the allocation of the selling expenses to the sale of shares – this action is not undertaken by the related taxable person, but by the intermediate holding company.

In our opinion, the costs being considered higher than the management fee applicable to that year and the costs being regarded as non-recurrent costs are two other questionable arguments, as the costs may then still be included in the VAT-taxed income (maybe not in full, but an entrepreneur is allowed to incur losses). Given the above we would not be surprised if the taxable person appealed.

(4) Practical consequences

In our opinion, it is important to include a clause in the management contracts – if possible – that supporting a possible sale forms part of the management activities, possibly as a final management activity. This should secure the deduction of input tax on selling costs for holding companies that perform management activities. This likewise applies to cases as the one brought before the Den Bosch Court of Appeal, in which the costs are not incurred by the holding selling the shares, while they are not charged on either. In this context, increasing the management payment in the event of an intended sale would appear to be wise.

Finally, in our opinion the taxable person in this judgment could even have invoked the so-called holding resolution. This stipulates that the deduction for holdings qualifying as entrepreneurs is fully determined by their supplies as entrepreneurs. Experience has shown the Tax Administration to now question the applicability of this resolution.

2. New policies application divestment facilities for corporate income tax purposes

The State Secretary for Finance has published two new policy decisions on the application of the divestment facilities for corporate income tax purposes. The policies relate to the split-up and the split-off.

(1) Policy decisions

The State Secretary for Finance has published two new policy decisions on the application of the divestment facilities for corporate income tax purposes. The policies relate to the split-up and the split-off. The two policy decisions became effective on January 27, 2015.

(2) Split-off ("afsplitsing")

A split-off is a legal concept under civil law, in which a company "splits off" part of its assets to another company. The company splitting off the assets continues to exist. Equity is transferred in terms of tax, so corporate income tax is basically due on any and all hidden reserves included in the assets split off. The Dutch Corporate Income Tax Act, however, includes a facility according to which direct levy is omitted, subject to satisfying certain conditions.

The possibility of splitting off part of a company's assets without corporate income tax being levied is commonly practiced. One of the situations where this might occur is when the legal structure of a group needs to be rearranged. The State Secretary published a decree recently, explaining his policy for applying that facility. The policy first of all needed an update because the Dutch Corporate Income Tax Act has gone through many changes since the publication of past decrees. The decree likewise focuses on the rising number of cross border split-offs. A crucial practical addition to the policy is a favorable regulation if requests for application of the facility have been filed too late.

(3) Split-up ("zuivere splitsing")

Other than with a split-off, a company whose assets are divested on the back of a split-up does cease to exist. In the event of a split-up the assets of the company ceasing to exist transfers to two or more acquiring companies. The split-up, too, is considered to be a transfer for corporate income tax purposes and a tax facility is likewise available. Although this facility has existed for nearly twenty years now, to date no related policy on applying this provision to a split-up had been published. For the first time the policy decision now published includes the so-called standard conditions for applying the divestment facility in the event of a split-up. The main features of the policy may substantially be compared those for the split-off. This, too, includes a regulation for requests filed too late and the tax consequences of cross-border split-ups are dealt with as well.

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