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Input VAT newsletter

Right to deduct VAT on "aborted deal" costs of holding company: Balanced decision of the Court of Justice of the European Union in the case C-42/19

13 November 2020

On 12 November 2020, the Court of Justice of the European Union (CJEU) issued its ruling in case C-42/19. This concerns an "active" holding company (i.e., a holding company that actively intervenes in the management of its subsidiaries) that had incurred VAT on costs regarding a potential acquisition of shares in another company that eventually did not materialize ("aborted deal" costs).

On the one hand, the CJEU decided that this company is allowed to deduct the VAT incurred on market studies related to the aborted transaction. However, on the other hand, the CJEU refused the deduction of the VAT incurred on banking costs linked to the issuing of bonds to finance the aborted transaction. This is because the funds collected, due to the abortion of the initial deal, had been since used for another activity that is not entitled to input VAT deduction. Therefore, the CJEU refused the company's argument that its original intention was to use these funds for activities that open the right to deduct VAT, focusing solely on the funds' effective use instead.

Background

The case refers to a Portuguese holding company that also manages and provides strategic coordination services to the companies it holds, which operate in the telecommunications, media, software and system integration markets. Therefore, this company could be qualified as a mixed "active" holding company, i.e., a company with both taxable and nontaxable activities. These types of companies can at least partly recover VAT on their costs under the conditions and the limits of the complex CJEU jurisprudence and its interpretation by the different national VAT authorities.

In 2005, this holding company wanted to invest in the new business segment "Triple Play". In this respect, it acquired consultancy services related to market studies to potentially acquire shares in another company. In addition, the holding company paid a taxable commission to a bank to put together and guarantee the placement of a private bond issuance. The company intended to use the capital obtained to acquire shares in the telecommunications company and to also provide technical support and management services to this company. The VAT at stake was around EUR1 million.

As the acquisition of the shares did not materialize, the holding company lent the unused borrowed money to its parent company.

The deduction of the input VAT incurred for both the consultancy services and the bank commission was denied by the Portuguese VAT authorities. This is because the acquisition of shares fell outside the scope of VAT and that the granting of credit was exempt; therefore, it does not entitle to input VAT deduction.

The company did not accept the VAT authorities' position and lodged a legal action with the Portuguese tribunals. In the course of this action, the Supremo Tribunal Administrativo decided to refer the case to the CJEU.

Opinion of the Advocate General

On 14 May 2020, the Advocate General of the CJEU, Mrs. Kokott, issued her conclusions. She first referred to the CJEU's case law regarding mixed holding companies as taxable persons, highlighting the recent Ryanair case (C-249/17) regarding the deductibility of expenditure arising in preparation for activities that the taxable person did not subsequently carry out. The Advocate General also emphasized that the disproportion between the amount of deductible VAT and the amount of a holding company's tax liability based on its planned management services—which regularly occurs in these cases—should not affect the principle that the VAT is deductible.

Therefore, the Advocate General considered that a mixed holding company, like the one in the present case, is entitled to a full deduction regarding expenditure for acquiring shares in a company to which it had intended to supply taxable services, even if this acquisition did not materialize.

However, the company had lent the capital of the issued bonds to its parent company. As such a loan is not entitled to input VAT deduction, the Advocate General considers that this VAT-exempt activity performed in the same tax period—rather than the originally planned activity— affects the deduction.

The company also argued that the VAT should remain deductible because the loan was temporary and the capital would ultimately be used to acquire shares as an active holding company. The Advocate General rejected this interpretation.

However, Mrs. Kokott opened the door to the regularization of the VAT, should the capital be effectively and eventually used for activities that create the right to deduct VAT and if the costs could be assimilated to capital costs. We should reiterate that article 55.2. of the Luxembourg VAT law rules that services that share the same characteristics as capital goods are subject to the five-year adjustment period (10 years in the case of immovable items).

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Decision of the CJEU

In its decision of 12 November 2020, the CJEU does not entirely follow the Advocate General's opinion. Indeed, we should highlight the following differences:

a) The CJEU distinguishes between market studies and banking costs, while the Advocate General did not;
b) The CJEU does not examine the question of the disproportion between the costs and the income, while the Advocate General did; and
c) The CJEU does not refer to the possibility of a regularization during the five-year period of the VAT that could not immediately be deducted, while the Advocate General opened the door to such a regularization.

However, points (b) and (c) do not come as a big surprise, as the Advocate General considered these points in her conclusion even though they were not actually part of the questions referred to the CJEU.

The CJEU allowed the deduction of the VAT incurred on the market studies because the company is an active holding performing, in a "recurring" manner, taxable economic activities (i.e., management services to the subsidiaries). To this extent, the CJEU's decision seems more favorable than the Advocate General's conclusions. However, the CJEU did not define what is meant by "recurring"; it may be necessary to refer to the case's fact pattern to understand this concept. The CJEU also reiterated that should the holding own some shares as an "active" holding and as a "passive" holding company, it would be only entitled to a partial deduction.

Unlike the Advocate General, the CJEU did not tackle the question of the disproportion between the costs and the income. This is unfortunate because, as practitioners and concerned businesses are aware, this question is of prime importance.

The CJEU refused the deduction of the VAT incurred on banking costs related to the issuance of bonds aimed to finance the aborted acquisition. This is because the company, while genuinely intending to acquire shares in a company to which it would later provide management services, ultimately lent the collected funds to its mother company. This activity does not open the right to deduct VAT.

In this respect, the CJEU refused the company's argument that it had intended to use these funds to acquire shares as an "active" holding and admitted the effective use of the funds as the sole criteria. Lastly, the CJEU did not confirm nor invalidate the Advocate General's opinion that it would be possible to regularize the VAT if the funds are used during the five-year adjustment period for activities that open the right to deduct VAT.

With this decision, the CJEU has added a further piece to its large jurisprudence puzzle regarding holding companies' VAT deduction rights. Therefore, concerned businesses should examine whether the CJEU's decision may affect them.

Deloitte Luxembourg's indirect tax team remains at your disposal to discuss the potential impacts of these developments on your organization.

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