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# Broken Deals and EU VAT

Ad van Doesum (Maastricht University, PwC Netherlands, ‘s-Gravenhage Court of First Instance) · Monday, July 6th, 2020

The VAT treatment of the issue, acquisition, holding and sale of shares has become a rather complicated affair over the last thirty years. The case law of the Court of Justice of the European Union (CJEU) on this topic is fundamentally ambiguous, causing serious legal uncertainty among businesses [1].

In its judgment in ***C&D Foods*** **(Case C-502/17)**, the CJEU has added another dimension to that problem: what happens if an acquisition or a sale of shares is aborted? In particular: can a holding company deduct the VAT on the costs that it incurred with respect to the intended acquisition or sale of shares? In ***Ryanair*** **(Case C-249/17)**, the CJEU ruled on an acquisition of shares which was eventually aborted. As seems to be the case with most of the CJEU’s case law on the EU VAT treatment of shares, these judgments not only provided answers, but also new questions.

Recently, Advocate-General Kokott delivered her opinion in ***Sonaecom*** **(Case C-42/19)** which also concerns a so-called ‘broken deal’. The litigant in this case, the Portuguese company Sonaecom, a mixed holding company, intended to purchase shares and issued bonds to finance the planned transaction. Ultimately, the acquisition failed to materialize. The capital that Sonaecom had obtained with the bond loan was eventually made available to the parent company. The Advocate General argues that a full right of deduction exists for the VAT on the costs relating to the cancelled acquisition of shares in a company. Her primary argument in this respect is that Sonaecom intended to supply taxable services to the target company. With regard to the costs relating to the issue of bonds, Kokott concludes that no right of deduction exists, as the actual use (for exempt supplies) takes precedence over the intended use (for activities for which a right of deduction exists).

The Opinion is an interesting read, not in the least because the Advocate General points out that CJEU’s case law contains an incentive for ‘seemingly artificial constructions’. However, in the same Opinion, Advocate General Kokott seems to ignore a fundamental question on the nature of the costs, i.e. whether they are in fact direct or general costs. This article will focus on these two aspects of the Advocate General’s Opinion.

**1. ‘Seemingly Artificial Constructions’**

It is settled CJEU case law that the mere acquisition and holding of financial holdings in other undertakings does not amount to an economic activity from which a taxable person status can be derived. However, CJEU has consistently held that the acquisition and holding of shares is an

economic activity if the holding of shares is accompanied by direct or indirect involvement in the management of the company in which the holding has been acquired, insofar as involvement of that kind entails carrying out transactions which are subject to VAT [2].

This exception seems to be subject to two conditions: there must be an involvement in the management of the subsidiary and there must be supplies for consideration to that subsidiary. However, CJEU's case law is somewhat ambiguous as to whether the involvement and the supply of services are two separate things. For example, in ***Marle* (Case C-320/17)**, the CJEU seemed to equate the supply of services with the involvement when it considered that 'the letting of a building by a holding company to its subsidiary amounts to involvement in the management of that subsidiary, which must be considered to be an economic activity giving rise to the right to deduct the VAT'.

To my mind, one of the reasons not to consider mere holding companies as taxable persons in the first place is that, to a certain extent [3], they are comparable to private investors (who are non-taxable persons). Yet, a holding company which is actively involved in the management of its subsidiaries and is, so to speak, 'indirectly economically active through its subsidiaries' [4] is, in my view, not comparable to a private investor. Although the CJEU could have gone in a different direction when it ruled in cases such as ***Welthgrove* (Case C-102/00)** and ***Floridienne and Berginvest* (Case C-142/99)**, it has never considered it to be enough for an economic activity to exist that the holding company is involved in the management of the subsidiary [5]. The CJEU requires that such involvement entails the supplies of services to the subsidiary for consideration. The reason seems to be that the supplies of goods or services for consideration are a precondition for any economic activity to exist. However, I believe it is incorrect to equate the supply of services for consideration with the involvement in the management, like the CJEU did in ***Marle* (Case C-320/17)**, even though I can see the practical benefit of only having to test whether supplies for consideration exist. The point is that, in order to separate the mere holding company and private investor from a controlling active holding company, it needs to be established to what extent the latter plays a different role from the former. The key lies in the involvement in the management, the supply of services for consideration to the subsidiary being a reflection thereof. Thus, the supply of services for consideration to a subsidiary should not, in itself, be enough to (also) consider the holding of the shares as an economic activity: there must be a connection with the involvement in the management. In other words: the involvement in the management should be coupled with the supply of services for consideration.

Notwithstanding the above, it is perfectly clear from the CJEU's case law that a holding company must supply services for consideration in order to have a potential right of deduction on costs relating to the acquisition and holding of shares. In this regard, it is immaterial whether the costs exceed the expected receipts of the planned services [6].

In practice, service (e.g., management) agreements are often put in place between the parent company and its subsidiary(ies) in order to allow for the deduction of input VAT. As the Advocate General points out, this is a consequence of the CJEU's case law itself. Already in her opinion in ***Ryanair* (Case C-249/17)**, Kokott had indicated that there may be a risk of 'seemingly artificial constructions of taxable services' entailing the 'creation' of (management) services for consideration for amounts less than the aggregated amounts of the costs incurred [7] and any future dividends to be paid out [8]. This is why, in the past, she had suggested a 'functional analysis' approach, and, now, seems to suggest that it would be better . In her opinion in ***Sonaecom* (Case C-42/19)**, the Advocate General subtly draws the Court's attention to the consequences of

departing from her advice.

**2. Direct or General Costs**

With respect to the costs that can be attributed to the intended supply of management services, the outcome of ***Sonaecom* (Case C-42/19)** is, in my view, reasonably predictable, because of its resemblance to ***Ryanair* (Case C-249/17)**. A full right of deduction exists.

However, ***Ryanair* (Case C-249/17)** has raised a rather fundamental question on the nature of the costs of an aborted acquisition of shares. The CJEU indicates that the intended, yet not materialized, management services constitute an economic activity. According to the CJEU, the transaction costs concerned are general costs. Typically, general costs give rise to a pro-rata right of deduction [9]. Yet, the CJEU rules that a full right of deduction exists. Although the CJEU does not provide much clarification in this regard, it seems that the CJEU considers the costs at hand as costs attributable to a well-defined part of the economic activity, being the (intended) supply of management services [10]. This approach bears resemblance to the concept of a 'clearly defined part of the economic activities', which the CJEU has first introduced in ***Abbey National* (Case C-408/98)**. And yet, the CJEU did not make any reference to the latter case. That way, the ruling in ***Ryanair* (Case C-249/17)** raised the question of how to establish the scope of deduction in case of general costs. Apparently, the classification of costs as general costs does not automatically lead to a pro-rata deduction.

In ***Sonaecom* (Case C-42/19)**, the Advocate General simply concludes that the expenditure has a direct and immediate link with the planned taxable services and that therefore, in principle, a full deduction of input VAT is to be allowed. Even though I agree with that outcome, and even though this is in line with ***Ryanair* (Case C-249/17)**, in my view, Advocate General Kokott ignores the fundamental question on the difference between direct and general costs. As a result, there is a fair chance that the CJEU judgment in ***Sonaecom* (Case C-42/19)** will not provide all the answers, in the continuing saga of EU VAT and holding companies.

*Email: ad.van.doesum@pwc.com; LinkedIn: https://www.linkedin.com/in/advandoesum/*

[1] See: Ad van Doesum, *The EU VAT Treatment of Shares and Other Securities* (March 26, 2020), available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561536 or http://dx.doi.org/10.2139/ssrn.3561536.

[2] CJEU, 14 November 2000, Case C-142/99, *Floridienne SA and Berginvest SA v Belgian State*, ECLI:EU:C:2000:623, para 19. See: A.J. van Doesum, H.W.M. van Kesteren and G.J. van Norden, *Share Disposals and the Right to Deduction of Input VAT*, 19 EC Tax Review 2 (2010), pp. 62-73, and J. Eggers and B. Ahrens, *The VAT Treatment of Holding Companies – German and EU VAT Practice Perspective*, 26 International VAT Monitor 3 (2015).

[3] One may however doubt whether a (mere) holding company is indeed comparable to a private investor, since a holding company usually fulfills a very different function than a private investor. See: Ad van Doesum, *The EU VAT Treatment of Shares and Other Securities* (March 26, 2020), available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561536 or http://dx.doi.org/10.2139/ssrn.3561536, at p. 5. See also: Opinion of Advocate General Kokott of 14 May 2020, Case C-42/19, *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira*,

ECLI:EU:C:2020:378, para. 46.

[4] Cf. Opinion of Advocate General of 14 May 2020, Case C-42/19, *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira*, ECLI:EU:C:2020:378, para. 47.

[5] It follows from *MVM* (Case C-28/16) that without also the provision of services for consideration, the holding of the shares cannot, by itself, be an economic activity. Cf. CJEU, Order of the Court of 12 January 2017, Case C-28/16, *Magyar Villamos M?vek Zrt. (MVM) v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*, ECLI:EU:C:2017:7, para. 34.

[6] Opinion of Advocate General Kokott of 3 May 2018, Case C?249/17, *Ryanair Ltd v The Revenue Commissioners*, ECLI:EU:C:2018:301, para. 28, and Opinion of Advocate General Kokott of 14 May 2020, Case C-42/19 *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira*, ECLI:EU:C:2020:378, para. 43.

[7] Opinion of Advocate General of 14 May 2020, Case C-42/19, *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira*, ECLI:EU:C:2020:378, para. 45.

[8] Opinion of Advocate General Kokott of 3 May 2018, Case C?249/17, *Ryanair Ltd v The Revenue Commissioners*, ECLI:EU:C:2018:301, para. 22.

[9] Cf. CJEU, 22 February 2001, Case C-408/98, *Abbey National plc v Commissioners of Customs & Excise*, ECLI:EU:C:2001:110.

[10] Cf. CJEU, 17 October 2018, Case C-249/17, *Ryanair Ltd v The Revenue Commissioners*, ECLI:EU:C:2018:834, para. 31.

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This entry was posted on Monday, July 6th, 2020 at 1:48 pm and is filed under Direct or General Costs, EU/EEA, Holding company, Share Dealings, VAT
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