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Highlights & Insights on European Taxation

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Year 2024, no. 4

TABLE OF CONTENTS

Court of Justice

(comments by **Kevin van Abswoude**) (*H&I* 2024/92)

– ***Feudi di San Gregorio Aziende Agricole*** **(C-341/22)**. Threshold for status of taxable person. VAT deduction. Court of Justice

(comments by **Madeleine Merkx**) (*H&I* 2024/88)

FREE ARTICLE

– ***Feudi di San Gregorio Aziende Agricole*** **(C-341/22)**. Threshold for status of taxable person. VAT deduction. Court of Justice

(comments by **Madeleine Merkx**) (*H&I* 2024/88)

The present case deals with a specific Italian legislative provision. Under this provision, companies that are established in Italy either through their main seat of business or a fixed establishment are regarded as shell companies or non-operational companies when the total amount of revenues, increase in inventories and income, excluding extraordinary income, is below the sum of the amounts obtained by applying certain fixed percentages. Of these percentages, none are mentioned in the referral by the Italian Supreme Court (*Corte Suprema di Cassazione*) or the Court of Justice of the European Union (hereinafter: 'CJ') in its judgment. In the Opinion of Advocate General (AG) Collins (AG Opinion of 28 September 2023, C-341/22, ECLI:EU:C:2023:719), only one of these percentages is mentioned: sub c: 15% of the value of the other fixed assets, including leasing contracts. Subs a and b of the Italian provision at play also mention a percentage of the assets but refer to different legal provisions. The complexity of the reference to other provisions is perhaps the reason that the other percentages are not mentioned in the referral, the AG Opinion and the judgment. If the provision applies, the shell company or non-operating company is deprived of its right to be granted a refund of a VAT credit resulting from the amount of deductible VAT being higher than the VAT due in a certain tax period. Instead, the shell or non-operating company can transfer it to the next tax period. In case the threshold mentioned above is not met in three consecutive tax periods/years, the right to a refund of the VAT credit is lost entirely. Where objective circumstances have rendered it impossible to achieve the revenues or have made it impossible to carry out the relevant transaction for VAT, the company concerned may request that the provision be disapplied. The purpose of the Italian legislation is to discourage the formation of shell companies and to prevent those companies from obtaining undue tax advantages.

The CJ's judgment

Referring to Article 9(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter: 'the VAT Directive') that a person that carries out an

economic activity, whatever the purpose or results of that activity is to be regarded as a taxable person, the CJ ruled that the status of taxable person is not dependent on that person obtaining an income above a certain threshold that is determined by a certain (fixed) percentage of its assets. The only relevant question is whether that person actually carries out an economic activity. In the same vein, the CJ also ruled that no provision of the VAT Directive makes the right of deduction conditional on the requirement that the output transactions exceed a certain (fixed) threshold. The provision can also not be justified as an instrument to combat fraud or abuse. The CJ mentioned that the right to deduct VAT can be refused only if the facts relied on to demonstrate such fraud or abuse have been established to the requisite legal standard, otherwise than by assumptions. Because the CJ answered the second question on the right to deduct VAT in the positive, it did not address the third question of the referring judge dealing with the principles of legal certainty and of the protection of legitimate expectations, which could preclude the Italian legislation under which the right to deduct VAT is denied to taxpayers not meeting the threshold in three consecutive tax periods.

Status of taxable person

The CJ's answer to the first question seems rather straightforward. The status of taxable person can be granted whatever the purpose or results of the activity. *Gmina L* (CJ 30 March 2023, C-616/21 *Gmina L*, ECLI:EU:C:2023:280) and *Gmina O* (CJ 30 March 2023, C-612/21 *Gmina O*, ECLI:EU:C:2023:279) have, however, demonstrated that that answer is not always so straightforward. Instead, it is relevant to compare the activities of the person at hand with the typical conduct of an active entrepreneur in the field concerned. Being in a continuous loss-making position is not typical for a business and, therefore, relevant in this regard. However, I agree with AG Kokott in her Opinion in *Latvijas Informacijas un komunikacijas tehnologijas asociacija* (AG Opinion of 7 March 2024, C-87/23 *Latvijas Informacijas un komunikacijas tehnologijas asociacija*, ECLI:EU:C:2024:222) that this is just one of the circumstances relevant to determine whether a person has a status as taxable person. A typical holding company, for that matter, may incur more costs than it receives in management fees because, e.g., it intends to recover the money lost from dividend payments or from later income from management fees, for example, after the start-up phase of a new subsidiary. In the *Gmina* cases, the CJ also referred to the fact that the Gminas did not employ staff for the activity at play, did not seek customers and that the activity was not of a recurrent nature, while there was also an unusual uncertainty of whether and to what extent the costs would be reimbursed via subsidies. The mere fact that the income is not above a certain threshold as such, as is the case in the Italian tax legislation at play, is thus not sufficient to regard a person as a non-taxable person. Because we only know for a fact in the present case that the income of Vigna is below the threshold and no other facts and circumstances are given, it is impossible to determine whether Vigna as such can be regarded a taxable person. With this in mind, it makes sense that the CJ plainly regards the Italian legislation as unacceptable from the general point of view that when a company's income is below a certain threshold, this cannot, as a general rule, result in a non-taxable person status.

The last thing I noted when reading the CJ's answer to the first question is, that the CJ refers in

paragraph 23 to the fact that the only relevant question is whether a person actually carries out an economic activity and 'that that person exploits tangible or intangible property for the purposes of obtaining income on a continuing basis'. From the AG Opinion, it becomes clear that Vigna leased its tangible and intangible assets (production facilities, equipment and a trademark) to Feudi. This type of activity qualifies as an exploitation of tangible or intangible property. The reference to *Gmina Wroclaw* (CJ 25 February 2021, C-604/19 *Gmina Wroclaw*, ECLI:EU:C:2021:132) is interesting, too, because that case demonstrates that for an exploitation of a property to be considered an economic activity, is it sufficient that the property is exploited and that an income is received for a certain period of time. No active steps similar to producers, traders or service suppliers need to be taken. The simple acquisition and the mere sale of an asset, on the other hand, cannot, however, amount to the exploitation of an asset intended to produce income on a continuing basis because the only consideration for those transactions consists of a possible profit on the sale of that asset. The CJ, in that situation, requires that a person has taken active steps to market property by mobilising resources similar to those deployed by producers, traders or persons supplying services (CJ 15 September 2011, C-180/10 and C-181/10 *Slaby and others*, ECLI:EU:C:2011:589). If those active steps have not been taken, there is no economic activity and no taxable person status (This difference is also explained by M.M.W.D. Merkx & N.P. Arzini, '*Handelen als vastgoedondernemer of als beheerder van privévermogen?*' (*Acting as a real estate entrepreneur or as a manager of private assets?*), *MBB* 2023/34, section 3.2). The threshold of being a taxable person for the exploitation of property, therefore, is lower compared to other activities. This is also demonstrated when we compare *Gemeente Borsele* (CJ 12 May 2016, C-520/14 *Gemeente Borsele*, ECLI:EU:C:2016:334) with *Lajvèr* (CJ 2 June 2016, C-263/15 *Lajvèr*, ECLI:EU:C:2016:392). Where, in *Gemeente Borsele* (C-520/14), the fact that only 3% of the costs made by the municipality were covered by parent's contribution to pupil transport resulted in no economic activity, in *Lajvèr* (C-263/15), the fact that the investments of the latter were largely financed by aids granted by Hungary and the European Union did not have a bearing on whether or not its activity could qualify as an economic activity (see in particular paragraph 38 of that judgment). The low threshold for the exploitation of a property to be regarded as an economic activity renders the Italian legislation even more disputable in the case at hand.

VAT deduction and abuse of law

If a person has the status of a taxable person and uses goods and services purchased for their taxed output, that person has a right to deduct. There is no rule stating that in order to deduct VAT, the income must exceed a certain threshold, as the CJ confirms in the present judgment. As a second step in the answer to the second question, the CJ addressed whether the provision could be justified because it prevents possible tax evasion, avoidance and abuse.

The CJ's ruling in this respect, in my view, simply basically needs to be understood in the sense that the income criterion used by Italy is unsuitable to demonstrate an abusive practice. In my view, the CJ rightfully comes to this conclusion. From the facts of the case, it does not become entirely clear what the tax advantage from a VAT standpoint would be. Rather, what becomes clear from the AG Opinion in the present case is that the provision deals with situations with the sole purpose of obtaining advantageous tax conditions for the management of shareholders' assets. If the group company to which the assets are leased (in this case, Feudi) has a full right to deduct

VAT, I do not see any tax benefit – from a VAT perspective – from charging low fees for services provided. There may be other benefits for the shareholders of Feudi, benefiting from a higher profit because of low costs. However, these other benefits cannot result in the conclusion that there is an abusive practice for VAT (cf. CJ 11 November 2021, C-281/20 *Ferimet*, ECLI:EU:C:2021:910, paragraph 59). In my view, the mere fact that the costs exceed the turnover achieved, even if viewed over a longer period of time or even the entire lifespan of a person, does not, by definition, mean that there is an abusive situation. The VAT Directive even demonstrates this implicitly. For example, companies that use subsidies to finance their activities, are in such a position on a permanent basis. Article 174(1) of the VAT Directive demonstrates that such a person is still to be regarded as a taxable person since the Member States can determine that subsidies that are not directly linked to the price of goods or services need to be included in the denominator of the deductible proportion. Next to the fact that, in my view, the costs being greater than the turnover of the output transactions is not by definition a tax advantage the grant of which would be contrary to the purpose of the VAT Directive, this fact also does not demonstrate by definition that the essential aim is to obtain that tax advantage.

Different from the CJ, AG Collins concluded that the Italian legislation is in line with Article 273 of the VAT Directive and does not infringe the principles of neutrality and proportionality because of the adequate possibility for the taxable person to provide proof to displace the presumption. This applies under the condition that the standard of proof required to displace the presumption is not excessively high. AG Collins referred to *Fontana* (CJ 21 November 2018, C-648/16, *Fontana*,ECLI:EU:C:2018:932). In this case, a sector study was used to determine turnover. According to the CJ, this was allowed if the sector study was correct, reliable and up to date. The difference between the turnover determined based on the study and the turnover reported by the taxable person can only give rise to a rebuttable presumption. The taxable person must be able to challenge both the accuracy of the sector study and/or the relevance of that study for the purposes of the assessment of his specific situation. Adjustment of the VAT due based on the sector study was done only in the case of significant differences between the turnover declared and the study. The CJ, on the other hand, referred to *Ferimet* (C-281/20) in which it stated that entitlement to the right to deduct VAT can only be refused if the facts have been established to the requisite legal standard, otherwise than by assumptions. First of all, it must be noted that different from *erimet* (C-281/20) and the present case, *Fontana* (C-648/16) deals with taxable turnover. Secondly, in the *Fontana* (C-648/16), a comparison is made with an average turnover in a certain sector, which is much more concrete than the situation where, more generally, the income does not exceed a certain percentage of the value of the assets. As mentioned above, the Italian legislation, in my view, does not cover situations where a tax advantage contrary to the purpose of the VAT Directive is obvious and also does not necessarily cover cases where the essential aim is to obtain that tax advantage. In my view, the burden of proof that these conditions have been met should be on the tax administration. Since the mere fact that costs are greater than the turnover does not demonstrate that these two conditions are met, the burden of proof should not be put on the taxable person to demonstrate that there are objective reasons why his turnover does not exceed a certain threshold (*contra* Opinion of AG Collins in the case at hand, paragraphs 43-45).

Holding companies

Even though the case at hand does not deal with holding companies, I wish to address them specifically because their position could be affected by the Italian legislation at play. Advocate General Kokott pointed out in her Opinion in *Ryanair* (AG Opinion of 3 May 2018, C-249/17, *Ryanair*, ECLI:EU:C:2018:301) that it is completely irrelevant to what extent management services are provided by a holding company to its subsidiaries. This could create a discrepancy between deductible VAT (on costs made by the holding company) and VAT due on output transactions. AG Kokott even speaks about artificial constructions where holding companies claim a substantial amount of VAT deduction because of management services that are provided against consideration regardless of the amount of that consideration (Opinion of 3 May 2018, C-249/17 *Ryanair*, ECLI:EU:C:2018:301, paragraphs 28 and 29).

In my view, it can be questioned whether the situation addressed by AG Kokott is undesirable. In this respect, it is important to note that a holding company has a certain function within a group of companies, and for that reason, in my view, the CJ applies a wide interpretation of the taxable person status for holding companies, where each type of service supplied to a subsidiary provides that status (CJ 5 July 2018, C-320/17 *Marle Participations*, ECLI:EU:C:2018:537). Even though there is a wide interpretation of the CJ in this regard, there are limitations. In case no open market value is applied, and the subsidiary does not have a full right to deduct VAT, Article 80 of the VAT Directive allows Member States to apply the open market value to the services because of management, ownership, membership, financial and/or legal ties in that situation. As becomes clear from *Finanzamt R* (CJ 8 September 2022, C-98/21 *Finanzamt R*, ECLI:EU:C:2022:645), a holding company cannot deduct VAT on costs that do not have a direct and immediate link with its own activities but instead, with those of its subsidiary. Where a group company, e.g., a holding company, decides to provide some of its services for free while others against a value that is in conformity with the open market value, it will, in principle, be faced with a limitation of deduction for providing services free of charge (*Hong Kong* (CJ 1 April 1982, C-89/81 *Hong Kong*, ECLI:EU:C:1982:121) and *Securenta* (CJ 13 March 2008, C-437/06 *Securenta*, ECLI:EU:C:2008:166)). Where a holding company decides not to provide services at all, with the exception of a small service against a consideration in conformity with the open market value, I am of the view that the position of a holding company within a group of companies justifies the right to deduct VAT, even though it may be able to deduct more VAT than it is due.

Last but not least, I should like to note that a similar issue arose in the Netherlands, where a company was providing services for an amount of 1,000 Dutch guilders, while it deducted 40,733 Dutch guilders in VAT. The Dutch Supreme Court ruled that in order to establish that the consideration is of a symbolic value which results in no economic activities taking place, the Court of Appeal should have established what services were provided to the participation and whether the consideration paid for those services was of a symbolic nature or not. The circumstance that the difference between the total costs incurred by it and the consideration it receives is extremely large, both absolutely and relatively, is not relevant according to the Dutch Supreme Court (Dutch Supreme Court, Decision No. 43927 of 11 July 2008, ECLI:NL:HR:2008:BD6833).

Transfer of going concern

As a final note, I wish to address the fact that becomes clear from paragraph 5 of the AG Opinion in the case at hand that the Italian tax authorities have taken the position that the lease of the property by Vigna to Feudi is to be regarded as the transfer of part of a business and, therefore, falls outside the scope of VAT. The CJ, however, ruled in *Mailat* (CJ 19 December 2018, C-17/18, *Mailat*, ECLI:EU:C:2018:1038) that the transaction by which an immovable property which was used for commercial purposes is let with all capital equipment and inventory items necessary for that use, even if the lessee pursues the activity of the lessor under the same name, cannot be regarded as the transfer of a going concern which is out of scope of VAT under Articles 19 and 29 of the VAT Directive.

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