

VAT NEWS

MIXED HOLDING COMPANIES: IS THE INPUT VAT ON PROCURED SERVICES PASSED ON TO SUBSIDIARIES DEDUCTIBLE?

(Case, C-98/21)

I. Introduction

The ECJ has recently ruled on the input VAT deduction right of a mixed holding company (i.e. which is also involved in the management of its subsidiaries) in relation to services acquired from third parties and used for the benefit of these subsidiaries in the form of a shareholder contribution.

There is no doubt that the input VAT deduction right of holding companies is a hot topic for many VAT practitioners and has already been the subject of many ECJ decisions (e.g. C-320/17, Marle Participations, C-42/19, Sonaecom etc.).

Besides, the VAT practice has already showed that holding companies may incur costs that are (partly) used for the activities of subsidiaries. However, the specificity of the present case is that the services purchased by the holding from third parties are contributed to the capital of its subsidiaries.

In this respect, please find below an overview of the facts of this case and the ECJ's judgment as well as our comments on the practical VAT implications of this judgment.

II. Facts of the case

W is a company active in the acquisition, management and use of properties, as well as the design, remediation and realization of building projects. It also holds majority participations in two entities, i.e. X (94%) and

Y (89%), which also carry out activities related to the construction and sale of real estate, mostly VAT exempt.

A decision was taken that W makes shareholder contributions to both subsidiaries (in proportion to its participations) for their construction projects. Thus, W supplied, *free of charge*, to the subsidiaries various kinds of services (e.g. architectural, stating calculation, energy supply, marketing services etc.). Those services were provided by W partly with its own staff and equipment, and by acquiring goods and services from third parties.

In addition, it was decided that W would supply accounting and management services *against a consideration* to the subsidiaries.

In its VAT returns, W deducted the entirety of the input VAT incurred on the costs purchased for the purpose of its shareholder contributions to X and Y.

However, the German VAT authorities challenged the input VAT deduction right of X considering that its shareholder contributions to the subsidiaries constitute activities falling outside the VAT scope, given that they are not carried out for the purpose of generating income in the sense of the VAT legislation.

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The German Court referred this case to the ECJ asking, in essence:

- i. whether a holding company supplying taxable output services to its subsidiaries is entitled to deduct the input VAT on services acquired from third parties and contributed to those subsidiaries in return for participation in its profit, although the obtained inputs are not linked to its own output transactions but instead to the (largely) tax exempt activities of the subsidiaries; and
- ii. in the affirmative, if the interposition of such holding company in the structure constitutes an abuse of law, given that the subsidiaries would have no input VAT deduction right should they purchase the concerned services directly.

III. Judgment of the Court

The ECJ reiterated its settled case-law according to which the input VAT deduction right is subject to the following two conditions: 1) the person concerned shall be a taxable person and 2) it shall use the goods/services acquired for the purposes of his output transactions.

Given that W is an active holding company, which supplied accounting and management services to the two subsidiaries in return for a consideration, the ECJ found that W indeed qualifies as a VAT taxable person.

Regarding the second condition, in line with its previous rulings, the ECJ pointed out that the following elements should be examined:

- ▶ the existence of a direct and immediate link between a particular input transaction and particular output transaction(s) giving rise to the right to deduct;
- ▶ in the absence of the above, whether the costs of the acquired services are part of the general costs of the taxable person and thus constitute components of the price of the goods/services he supplies. In such case, the costs would have a direct and immediate link with the taxable person's economic activity as a whole.

More importantly, the ECJ stressed that the objective content of the transaction concerned shall be taken into account. Thus, one shall assess the actual use of the goods/services acquired by the taxable person.

In light of the above, the ECJ found that W does not fulfil this second condition on the following grounds:

- ▶ the input services obtained by W are not used to supply its VAT taxable output accounting and management services to the subsidiaries (i.e. an economic activity granting an input VAT deduction right);

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- ▶ the input services cannot be regarded as having a direct and immediate link with W's economic activity as a whole, given that they solely constitute the object of its shareholder contribution to the subsidiaries. It is the Court's opinion, which could be further discussed, that from a VAT standpoint such contributions (whether in cash or in kind) correspond to the mere holding of shares, i.e. an activity falling outside the VAT scope.

In addition, according to the Court, the actual use of the services obtained by W (i.e. their transfer free of charge to the subsidiaries for their own transactions) establishes a direct link of the services with the activities of those subsidiaries.

Since no right to deduct can arise from expenses linked not to transactions carried out by the taxable person, but to transactions carried out by a third party, the Court concluded that W is not entitled to deduct the input VAT incurred on these expenses.

IV. Comments

This ruling, which is in line with ECJ's settled case-law, reminds to holding companies the importance of applying a correct methodology when determining their input VAT deduction right.

As the objective content of the transactions and the actual use of the goods/services purchased by a taxable person play a decisive role, holding companies should not deduct

input VAT on costs that are not used by themselves but are passed on to subsidiaries for the performance of their own activities.

Most importantly, holding companies should be in the position to demonstrate, based on the economic reality of the transactions and the underlying legal / accounting documentation, that a direct and immediate link between their activities granting an input VAT deduction right and the costs on which input VAT has been deducted exists.

To this end, holding entities should pay attention to the following elements:

- ▶ in case they supply services to subsidiaries in return for a consideration that grant an input VAT deduction right, it is important that i) such supply is provided for in their articles of association, ii) the respective services agreements are put in place and iii) they have enough substance to do so;
- ▶ for services purchased on which input VAT has been deducted, to ensure that, based on the services agreements in place and the invoices issued, it infers that they are the actual recipients of these services.

V. How could BDO help you ?

Should you have any questions on the above, or need assistance with applying the correct input VAT deduction methodology, please feel free to contact our VAT experts.

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