



VAT update for private equity

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■ Agenda

- Introduction
- Passive holding vs active holding
- Determination of the VAT deduction right of active holdings
- New decision issued by the CJEU related to abort costs

Introduction

- The most sensitive VAT topic during the last two decades in the private equity sector: input VAT deduction right for active holding companies.
- This topic has been subject to many decisions issued by the Court of Justice of the European Union (“CJEU”) since 1991 (see Polysar case, C-60/90 dated 20 June 1991).
- Despite the abundant jurisprudence on this topic, questions are still referred before the CJEU showing the difficulties of application by the Member States. This has been recently proved with the last decision ruled by the CJEU: Sonaecom case, C-42/19 dated 12 November 2020.

Passive holding vs Active holding

■ What about a pure shareholding activity?

The mere holding of shares without any involvement in the management of the subsidiaries cannot be assimilated to the exploitation of intangible property and any dividends generated are merely the product of passive ownership → not an economic activity for VAT purposes*

■ What about a holding company involved in the supply of services to its subsidiaries?

In case of supply of services to its subsidiaries → this constitutes an economic activity for VAT purposes qualifying the holding company (also called “active”) as a taxable person for VAT purposes**.

* CJEU, Polysar Investments, C-60/90, 20 June 1991; CJEU, Sofitam, C-333/91, 22 June 1993

** CJEU, Floridienne SA and Berginvest SV, C-142/99, 14 November 2000

Passive holding vs Active holding

■ Interest of such distinction:

- entitlement to an input VAT deduction right.
- *“In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay (...) .*

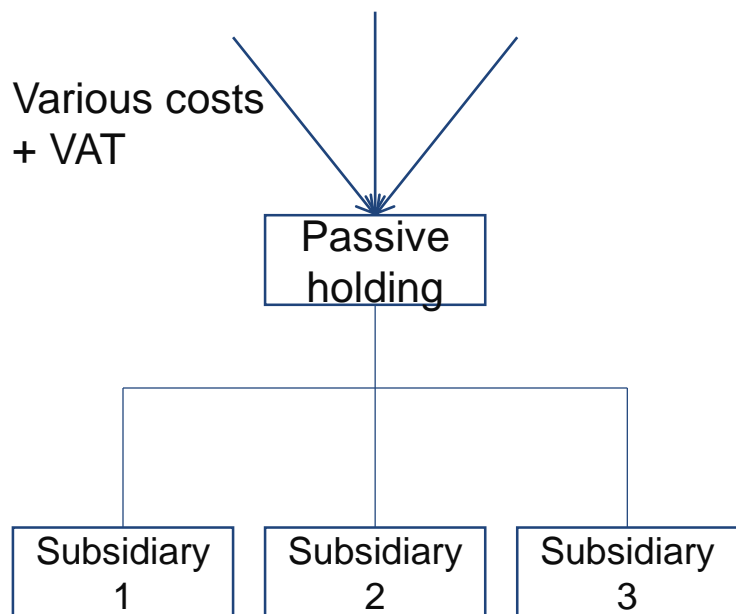
■ In case of a pure shareholding activity:

- no input VAT deduction right (as no economic activity entitling to).

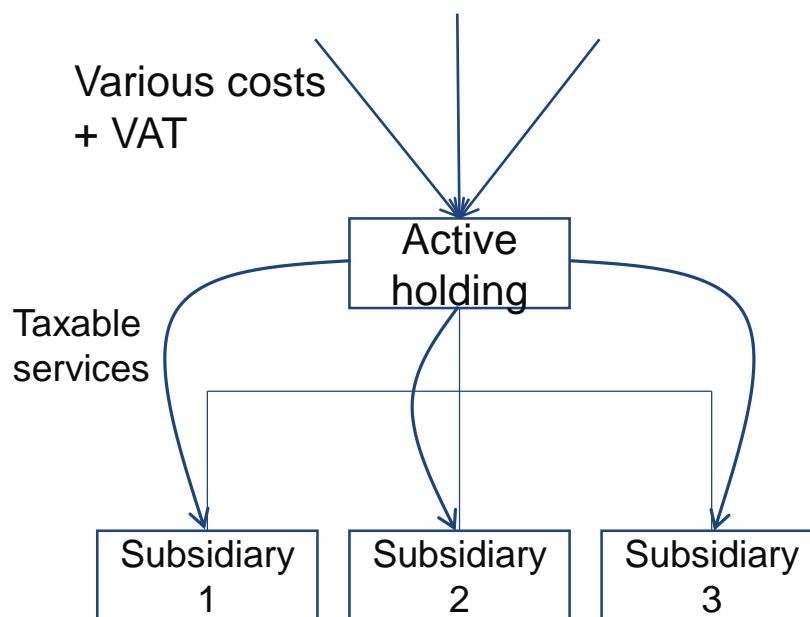
■ In case of a taxable activity in addition to the shareholding one:

- input VAT deduction right open for active holdings due to this taxable activity.

Passive holding vs Active holding



VAT incurred on expenses: final cost!



VAT incurred on expenses: deductible if linked to the taxable activity

VAT deduction right of active holdings

■ How to determine the VAT deduction right of active holdings?

Active holdings are usually involved in the following activities:

- Activities falling outside the scope of VAT not entitling to any input VAT deduction right (e.g. shareholding activity);
- Activities falling within the scope of VAT which are taxable and entitle to an input VAT deduction right (e.g. supply of administrative services);
- Activities falling within the scope of VAT but that are VAT exempt without entitling to any input VAT deduction right (e.g. EU financing activity).



Mixed activities (entitling and not entitling to an input VAT deduction right): use of methods for the determination of partial input VAT deduction

VAT deduction right of active holdings

■ Principle laid down by the CJEU:

- **Direct allocation:** Input transactions subject to VAT that have a direct and immediate link with one or more output transactions giving rise to deduct VAT: full input VAT deduction right.
- **Overhead costs:** expenses that cannot be directly allocated to a specific output transaction have to be considered as general expenditures which by nature are linked to the taxable person's overall economic activities (i.e. excluding the shareholding activity): deduction depending on the VAT treatment of the economic activities (e.g. taxable or VAT exempt).



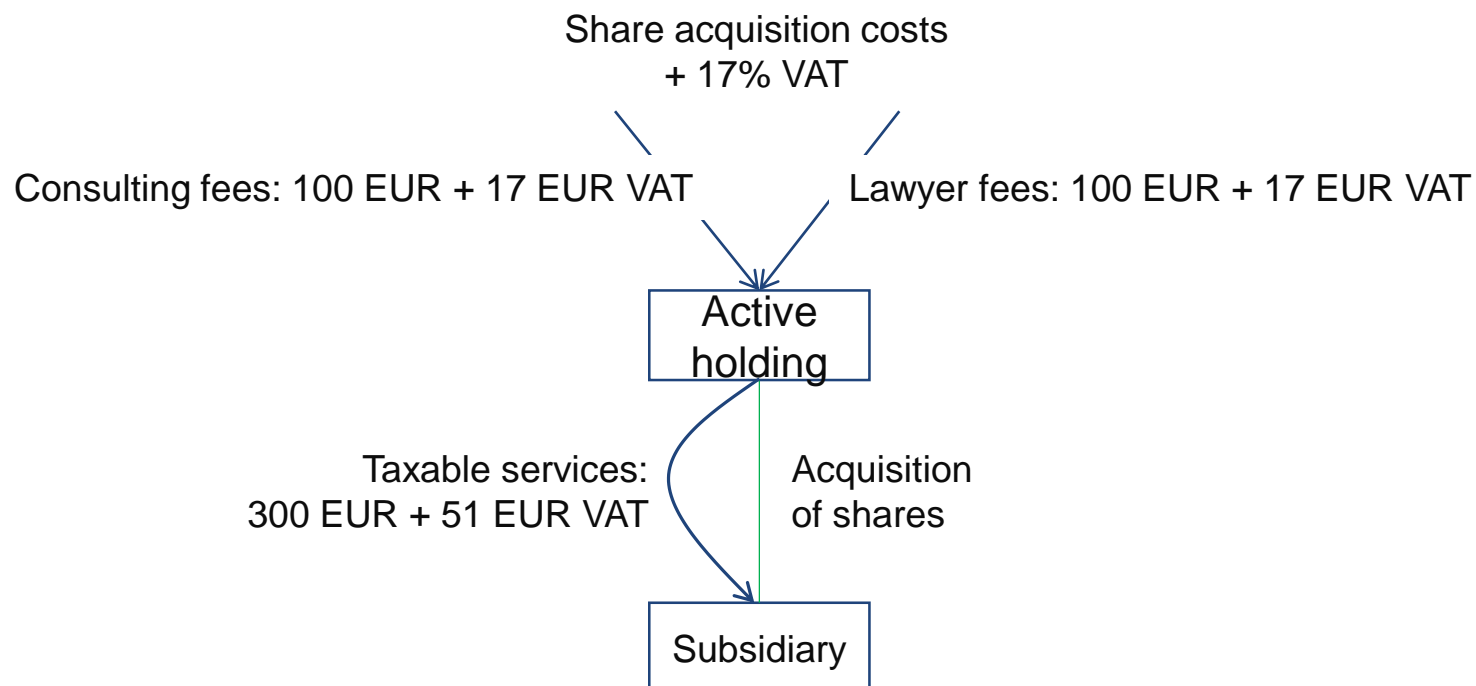
Question of VAT deduction of active holdings easily answered in theory.

However, these guidelines encounter difficulties in the application.

VAT deduction right of active holdings

- **Input VAT on share acquisition costs (CJEU, Cibo Participations, C-16/00):**
 - Supply of taxable services to a company into which it has acquired participations constitutes an economic activity.
 - Share acquisition costs cannot be allocated to a specific activity and have to be considered as overhead costs which have by nature a direct and immediate link with the overall economic activity (i.e. excluding the shareholding one) of the holding company.
 - Where the economic activities include activities entitling and not entitling to an input VAT deduction right (e.g. EU financing): apportionment of the costs between these two activities required (e.g. computation of a prorata).

Determination of the VAT deduction right of active holdings



Various costs = overhead costs → linked to the taxable activity → 34 EUR input VAT fully deductible

VAT deduction right of active holdings

■ Concept of “involvement in the management of subsidiaries”:

= any services supplied by a holding company to its subsidiary provided that:

- 1) the supply is made on a continuing basis;
- 2) the supply is carried out for consideration;
- 3) the supply is subject to VAT; and
- 4) direct link between the service rendered by the supplier and the consideration received from the beneficiary*.

This includes the supply of administrative, financial, commercial and technical services to subsidiaries**, as well as the letting of an immovable property (subject to VAT)***.



If full involvement : full VAT deduction

* CJEU, Marle Participations, C-320/17, 5 July 2018, §35

** CJEU, Larentia+Minerva, joined cases C-108/14 and C-109/14, 16 July 2015, §21

*** CJEU, Marle Participations, C-320/17, 5 July 2018

VAT deduction right of active holdings

- **Apportionment of expenditures based on the partial involvement in the management of subsidiaries (CJEU, Larentia + Minerva, joined cases C-108/14 and C-109/14)**
 - Situation where the holding company incurs expenditures in the context of acquisition of shares in subsidiaries but involves itself in the management only of some of those subsidiaries.
 - Expenditures incurred in such context must be regarded as only partially belonging to its general expenditures. Therefore, only input VAT on the part of expenditures considered as belonging to the overhead costs can be deducted.
 - The apportionment method has to be determined by Member States.

VAT deduction right of active holdings

■ Abort costs (CJEU, Ryanair, C-249/17)

- Abort costs (e.g. legal or due diligence costs) linked to an unsuccessful bid to take over the shares of a competitor.
- The acts performed with the mere intention to supply management services to the intended target company constitute preparatory acts for a taxable activity and therefore are sufficient to qualify the holding company as a taxable person at the time when incurring such costs.
- Such abort costs constitute general expenditures linked to the economic activities of the holding company: full input VAT deduction right granted in view of the intended taxable activity, even if not materialized at the end.

VAT deduction right of active holdings

- **Share disposal costs (CJEU, BLP, C-4/94; AB SKF, C-29/08; C&D Foods Acquisition, C-502/17)**
 - BLP case (06/04/1995): the sale of shares constitutes a VAT exempt activity which does not entitle to any input VAT deduction right.
 - AB SKF (29/10/2009): Distinction between costs allocated to the sale of shares and general costs not allocated to a specific transaction:
 - if costs are incorporated in the share sale price: directly linked to a VAT exempt transaction, so no input VAT deduction can be granted;
 - If costs are not incorporated in the share sale price: general expenditures linked to the global economic activities of the holding.
 - C&D Foods Acquisition (08/11/2018): the sale of shares should not grant a VAT deduction right on related expenditures. However, if the direct and exclusive reason for the sale of shares relates to the taxable activity of the parent company, a VAT deduction right might be granted for related costs.

New CJEU decision re abort costs

■ Sonaecom case, C-42/19, 12 November 2020

- Context: Sonaecom is an active holding providing strategic management and coordination services in the field of telecommunications and media.

In view of a possible acquisition of shares in a company active in the telecom sector to which Sonaecom intended to provide taxable management services, Sonaecom required (i) the assistance of a consulting firm for market study services and (ii) banking services linked to the funding of such acquisition but which was used at the end to fund the parent company.

However, the acquisition did not materialize at the end but Sonaecom deducted all the input VAT incurred on the above services.

The Portuguese VAT authorities challenged this VAT deduction.

New CJEU decision re abort costs

■ CJEU decision:

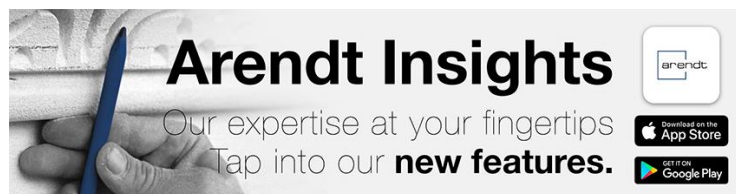
- Consulting costs: if the company intended to render taxable services to the target, such costs can be considered as preparatory acts. These costs must be regarded as belonging to the general costs and input VAT on that costs should in principle be fully deductible unless some output transactions of the company are VAT exempt.
- Banking services for the funding of the acquisition (finally used for financing the parent company): if the services are subsequently used for a VAT exempt activity (i.e. financing activity), no VAT deduction can be granted for these costs, based the actual use of goods and services.



This CJEU decision is in line with the previous Ryanair case. However, the CJEU further specifies the interaction between the initial intention and the actual use of the services and goods acquired, the latter taking precedence over the first one.

Questions / Answers

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