KÜFFNER MAUNZ LANGER ZUGMAIER

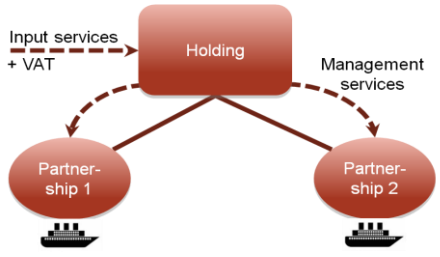
KMLZ VAT NEWSLETTER

Federal Fiscal Court refers questions on input VAT deduction of holding companies to ECJ

With two decisions of 11 December 2013, the Federal Fiscal Court has referred questions for a preliminary ruling on the scope of input VAT deduction by holding companies to the European Court of Justice (C-108/14 and C-109/14).

1. Starting point

The parent companies of partnerships operating ships had incurred input VAT on the costs of raising capital for financing of the partnerships. After establishing the partnerships the holding companies supplied management services to the partnerships which were subject to VAT. The tax authorities denied the full input VAT deduction.



Federal Fiscal Court changes view on input VAT deduction by holding companies

The Federal Fiscal Court has referred questions on the scope of input VAT deduction by holding companies and several questions regarding VAT groups to the European Court of Justice (ECJ). The decision on the input VAT deduction of holding companies is of particular relevance as the Federal Fiscal Court has taken the position that the input VAT deduction is possible only in a restricted extent. Holding companies should prepare for an approving verdict of the ECJ and take steps to secure the input VAT deduction. The questions on VAT groups will be dealt with in our next newsletter.

According to traditional understanding, the two holding companies would have been entitled to a full input VAT deduction. The two holding companies carry out an economic activity as the holding of the shares in the subsidiaries was accompanied by an involvement in the management of the subsidiaries by way of taxable management services.

The fact that the costs incurred in connection with the financing of the two subsidiaries would not have been detrimental to the input VAT deduction. This is because pursuant to the decision of the ECJ of 27 September 2001 (Case C-16/00, *Cibo Participations*) expenses in connection with the acquisition of shares in a company have a direct and immediate link with the taxable person's business as a whole. If such activity is not detrimental to the input VAT deduction, the taxable person can fully deduct the input VAT.

2. The decisions of the Federal Fiscal Court

The Federal Fiscal Court takes the position that the holding companies may not fully deduct the input VAT incurred for the expense of establishing the subsidiaries. The Federal Fiscal Court argues that the expenses are closely connected with the acquisition and the holding of the shares in the subsidiaries rather than with the supply of management services to the subsidiaries. Therefore, it is necessary to split up the input VAT amounts. The Federal Fiscal Court has referred to the ECJ the question as to which method is applicable for calculating the proportion of deductible input VAT. According to the Federal Fiscal Court the following methods are conceivable:

- Determination by reference to the percentage of turnover resulting from carrying out management services in relation to the turnover resulting from the holding of the shares in the subsidiaries ("turnover-based method"),

- Determination by reference to the percentage of the investment made for the management services in relation to the investment made for acquiring the shares in the subsidiaries ("investment method"),

- Determination by reference to economic numbers (e.g. the number of employees engaged in the management of the participation or the costs spent on the two activities).

The ECJ should determine the method for calculating the proportion of deductible input VAT in order to establish the uniform application of the VAT Directive.

3. Summary/Recommendations

The decisions of the Federal Fiscal Court mark a break as they call into question the hitherto accepted principles of input VAT deduction by holding companies. If the ECJ confirms the position of the Federal Fiscal Court, it will be decisive as regards which method of splitting up the input VAT amounts the ECJ decides is to be applicable. Which method is the most favorable for a particular holding company depends on the circumstances of the respective case at hand. Generally, a turn-over-method is favorable if the amount of dividends is lower than the remuneration for the management services. An investment method is favorable if the shares in the company were relatively cheap.

As the ECJ might follow the Federal Fiscal Court's restrictive position, holding companies should start preparing for an unfavorable decision in order to secure the input VAT deduction. If holding companies are currently planning to acquire subsidiaries, they might be able to apply for an advance revenue ruling with the competent tax office.

Apart from this, holding companies should start gathering together the facts which allow for an input VAT deduction pursuant to the various methods of splitting up the input VAT. Further, holding companies should consider structuring the holding of the subsidiaries so that they are in a favorable situation irrespective of which method of splitting up the ECJ considers applicable.

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