



No 2nd class taxable person – holding companies entitled to input VAT deduction

1 Background

Tax authorities repeatedly challenge the right of holding companies to deduct input VAT as regards their holdings. This is based on two VAT principles. Firstly, only taxable persons are entitled to input VAT deduction and secondly, only input VAT resulting from an economic activity is deductible. It is only in exceptional circumstances, that the acquisition, ownership and sale of holdings are regarded as economic activities. If the purpose of a company is limited to these activities, the company is generally not a taxable person. Such companies are, in theory, called “holding companies”.

In practice, however, the purpose of a holding company is often not limited to the acquisition, ownership and sale of holdings. Holding companies are often economically active in terms of both third parties and their own affiliates (so-called mixed or parent companies). If input VAT results from economic activities, the holding company, being a taxable person, is also entitled to input VAT deduction. This also applies for input VAT resulting from supplies received, which are consumed in preparation of an economic activity, which ultimately fails.

2 Facts

In 2006, the airline Ryanair unsuccessfully attempted to acquire its competitor, Aer Lingus. In pursuit of this goal, Ryanair received consultancy services subject to Irish VAT. If the acquisition had been successful, Ryanair would have supplied management services to Aer Lingus. Ryanair therefore claimed input VAT deduction from the Irish tax authorities.



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3 ECJ decision

In its judgment, the ECJ confirmed Ryanair's claim for input VAT deduction. Ryanair had procured the consultancy services in order to prepare an economic activity. It aimed to acquire Aer Lingus, not only for the purpose of holding, but also with a view to providing management services to Aer Lingus. Although the procured consultancy services would not have been directly and immediately linked to the intended management services, these general expenses, formed part of Ryanair's planned overall economic activity.

The ECJ seems to view this as a basic principle (see also Note 29 of the opinion of 03.05.2018). Notably, the ECJ does not require that the intended output supplies exist in any particular ratio to the value of the input supplies. This was proposed by the Commission in a procedural statement. Therefore, input VAT deduction could exceed a company's output VAT liability.

4 Consequences

By means of its judgement, the ECJ has, once again, confirmed that holding companies are not second class taxable persons. As regards input VAT deduction, what is relevant is whether or not a taxable person procures the input supplies for its business. A holding company may or may not be a taxable person. If a holding company is a taxable person, its supplies are within the scope of VAT. The holding company is basically entitled to input VAT deduction for the input supplies purchased for this purpose.

Against this background, the classification of a company as a holding or parent company does not result in any additional value. In fact, the term "holding company" is rarely used in the ECJ's reasons for judgement. Rather, the focus should be placed on the substantive and legal issues. If this approach was used consistently, it would speed up audits and provide assistance in terms of avoiding financial disputes. In particular, the tax authorities must now rethink their approach to such issues. Although it is an Irish case, the tax authorities must observe ECJ case law (see German Federal Fiscal Court, decision of 13.12.2017 – XI R 4/16, recital 52).

Acquirers of holdings should consider whether they are or wish to be economically active. The focus should not be purely on the deduction of input VAT. Additionally, the VAT consequences for the holding period and a possible sale should be assessed. If the acquisition is within the scope of the acquirer's economic activity, it should document this in an objectively comprehensible manner. The acquirer bears the burden of proof and should therefore take the necessary precautionary measures. Declarations of intent, calculations, strategy papers and/or written communications with the tax office should be considered. The economic intention should also be expressed in records dealing with the company's purpose and its external appearance (e.g. in annual reports). Any contradictions will serve to strengthen the arguments of the tax authorities.